U.S. Congress. Senate.

Investigation of railroads, holding companies...pt.1-2

Washington

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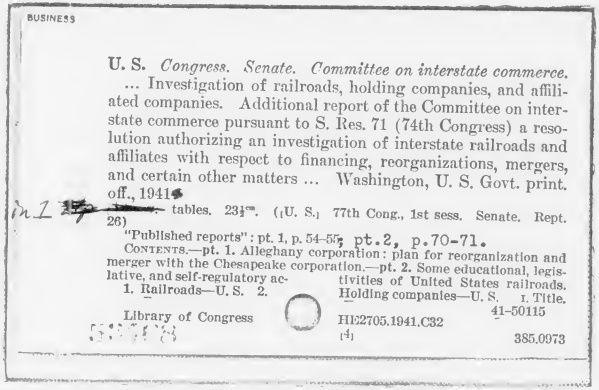

BUSINESS

U. S. *Congress. Senate. Committee on interstate commerce.* ... Investigation of railroads, holding companies, and affiliated companies. Additional report of the Committee on interstate commerce pursuant to S. Res. 71 (74th Congress) a resolution authorizing an investigation of interstate railroads and affiliates with respect to financing, reorganizations, mergers, and certain other matters ... Washington, U. S. Govt. print. off., 1941

2v. in 1 [illegible] tables. 23½cm. (U. S., 77th Cong., 1st sess. Senate. Rept. 26)

"Published reports": pt. 1, p. 54-55; pt. 2, p. 70-71.

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1. Railroads—U. S. 2. Holding companies—U. S. I. Title.

Library of Congress HE2705.1941.C32 [4] 41-50115 385.0973

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TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 11:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 4-3-98 INITIALS: [illegible]

TRACKING # : 30989

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Part 1

U.S. CONGRESS. SENATE

INVESTIGATION OF RAILROADS, BANKING
INSURANCE, AND AFFILIATED COMPANIES

77TH CONGRESS, 1st Session | SENATE | REPORT No. 26, PART 1

INVESTIGATION OF RAILROADS, HOLDING COMPANIES, AND AFFILIATED COMPANIES

ADDITIONAL REPORT

OF THE

COMMITTEE ON INTERSTATE COMMERCE

PURSUANT TO

S. Res. 71

(74th Congress)

A RESOLUTION AUTHORIZING AN INVESTIGATION OF INTERSTATE RAILROADS AND AFFILIATES WITH RESPECT TO FINANCING, REORGANIZATIONS, MERGERS, AND CERTAIN OTHER MATTERS

ALLEGHANY CORPORATION: PLAN FOR REORGANIZATION AND MERGER WITH THE CHESAPEAKE CORPORATION

FEBRUARY 6, 1941.—Ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1941

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NOTE.—This is the first of a series of reports to follow Senate Report No. 25 (in 27 parts) of the Seventy-sixth Congress. For titles see list of published reports.

77TH CONGRESS } SENATE { REPORT No. 26
1st Session } { PART 1

INVESTIGATION OF RAILROADS, HOLDING COMPANIES, AND AFFILIATED COMPANIES

FEBRUARY 6, 1941.—Ordered to be printed

Mr. WHEELER and Mr. TRUMAN, from the Committee on Interstate Commerce, submitted the following

REPORT

[Pursuant to S. Res. 71 of the 74th Cong.]

ALLEGHANY CORPORATION—PLAN FOR REORGANIZATION AND MERGER WITH THE CHESAPEAKE CORPORATION

I. INTRODUCTION

This report deals with a proposal to reorganize the largest United States railroad holding company, Alleghany Corporation, and to merge it with its subsidiary, The Chesapeake Corporation.[1] Hearings on this subject are reported in part X of the hearings of this subcommittee; [2] relevant material is also contained in part VII.[3]

A REFORM MANAGEMENT TAKES THE HELM

On May 5, 1937, Robert R. Young and two associates, Frank Kolbe and Allan P. Kirby, purchased from the George and Frances Ball Foundation a block of stock which gave them control of Alleghany Corporation.[4] The purchase was in such form that the Young-Kolbe-Kirby syndicate held control for at least 2 years on an investment of $1,512,405.70.[5] The syndicate was so set up that actual

[1] The proposal, or "Plan of Consolidation," is printed as Exhibit No. 1248, Hearings, Part X, pp. 4456–4475.
[2] Hearings, Part X, pp. 4051 sqq.
[3] Hearings, Part VII, pp. 2269 sqq.
[4] Another report of this subcommittee, in preparation, deals with the formation of the George and Frances Ball Foundation as a tax-reducing device, and with the sale by it of the controlling block of Alleghany stock to the Young-Kolbe-Kirby syndicate. (See also Hearings, Part VII, pp. 2269 sqq.)
[5] Exhibit No. 453, Hearings, Part VII, p. 2589.

control rested in the hands of Robert R. Young.[6] Mr. Young's personal investment in the controlling block of stock was $254,295.92.[7]

For this $255,000 Mr. Young acquired control of the remains of the vast corporate empire accumulated by the Van Sweringens with the banking assistance of J. P. Morgan & Co. Alleghany Corporation controlled more than 200 other corporations, including four eastern railroads (the Chesapeake & Ohio, the Erie, the Nickel Plate, and the Pere Marquette), operating 9,500 miles of track, and (subject to the jurisdiction of the bankruptcy court) the Missouri Pacific railroad system, operating 12,500 miles of track. In addition to these railroads, Alleghany controlled coal companies and hotels, peach orchards, barge lines, busses, real-estate companies, and a host of miscellaneous enterprises. For his $255,000 Mr. Young secured control (subject in many instances, however, to the jurisdiction of bankruptcy courts) of corporations whose assets had a book value totaling almost $3,000,000,000.[8] Young-controlled railroad companies employed more than 100,000 men, with a total pay roll of more than $170,000,000 per year.[9]

Mr. Young took shoestring possession of this empire on May 5, 1937. The following day, in testimony before this subcommittee, he frankly admitted that the holding-company system which made possible such concentration of power was "a bad thing."

Mr. YOUNG. * * * *I think it is a bad thing for any individual to have such power. I think it is bad.*[10]

In addition to admitting freely that concentration of power through pyramided holding companies was bad, Mr. Young acknowledged that he knew of many of the abuses which had occurred within the Alleghany system, and especially within the Chesapeake & Ohio branch of the Alleghany system, in previous years.

Mr. LOWENTHAL. * * * Hearings of this subcommittee brought out the fact that the Chesapeake & Ohio and its subsidiary, Virginia Transportation Corporation, at various times in 1930 and in 1931 had falsified their books of account in connection with that transaction [a dummy option contract for purchasing control of the Chicago & Eastern Illinois [11]] by setting up as deposits on the books of account money that was not on deposit at all, money in the amount of millions of dollars. I wondered whether you had been apprised of that testimony before this subcommittee?

Mr. YOUNG. I had heard about it, and *I have already taken steps to inquire into the other end of it, into our side of it.*

Mr. LOWENTHAL. You would disapprove of anything of that kind, would you not?

Mr. YOUNG. Emphatically. *Anything that does anything to falsify records, I think, is very bad.*[12]

* * * * * * *

[6] The Young-Kolbe-Kirby syndicate assigned control to Young, Kolbe & Co., as agent. (Exhibit No. 454, ibid., p. 2589 at p. 2591.) Mr. Young has a 70-percent interest in that firm. (Hearings, Part VII, p. 2300.)

The CHAIRMAN. So that, Mr. Kirby, the dominant figure in the Allegheny system will be really Mr. Young, not withstanding the fact that you put up most of the money? The dominant figure in the control, management, and so forth, is going to be Mr. Young?

Mr. KIRBY. That is correct. (Hearings, Part VII, p. 2301.)

[7] See footnote to Exhibit No. 453, Hearings, Part VII, p. 2589, discussed at pp. 2302-2305.

[8] A chart showing the corporate relations of the 206 Alleghany-controlled corporations as of June 30, 1936, appears as Exhibit No. 5, Hearings, Part I, facing p. 216. A table showing net book assets of Alleghany-controlled operating subsidiaries appears as Exhibit No. 7, ibid., pp. 219–222. The latter indicates that about 36 percent of the book assets ($1,096,323,584 out of $2,994,721,763) were owned by companies in reorganization. (Ibid., at p. 222.)

[9] Exhibit No. 13, Hearings, Part I, p. 227.)

[10] Hearings, Part VII, p. 2307. [Italics supplied.]

[11] For discussion of the Chicago & Eastern Illinois dummy option contract, see Hearings, Part VIII, pp. 2798 sqq., and Report No. 25, Part 5, of this subcommittee, entitled: "Chicago & Eastern Illinois Ry. Co.—Concealment of Loan Transaction with C. & O. Ry. Co."

[12] Hearings, Part X, p. 4274. [Italics supplied.]

Mr. LOWENTHAL. Another set of hearings of this subcommittee produced evidence indicating that in 1930 and 1931 the Chesapeake & Ohio lent millions of dollars to the Bremo Corporation [13] to enable that corporation to maintain its ownership of stock purchased on margin for the purpose of getting control of the Chicago Great Western. These loans enabled, according to the testimony before the subcommittee, that speculative syndicate to continue control and to maintain improper relations between the control of Great Western on the one hand and shippers' representatives on the other.

Mr. YOUNG. *From what I have heard about that, I do not like it.*[14]

* * * * * * *

Mr. LOWENTHAL. * * * In the same set of hearings [15] there was evidence that the Chicago Great Western's board declared improper dividends, dividends which should not have been declared at the time, when the railroad ought not to have been paying money in dividends, and that a considerable portion of those dividends were used by the Bremo syndicate to pay interest on its obligations to the Chesapeake & Ohio or its subsidiary on loans made by them to Bremo, and that shortly thereafter it became necessary for the Chicago Great Western to go to the Reconstruction Finance Corporation and borrow relief funds in almost the very amount paid out in dividends.

Mr. YOUNG. *I think that was very bad.*[16]

* * * * * * *

Mr. LOWENTHAL. * * * The evidence showed that in 1930 the Chesapeake & Ohio caused the Chicago & Eastern Illinois to obtain a loan of relief funds from the Reconstruction Finance Corporation on financial representation statements which were in effect fraudulent.[17] I wondered whether that particular transaction had been called to your attention.

Mr. YOUNG. I had heard about that vaguely; *and that is one of the things that we are going to inquire into.*[18]

In addition, Mr. Young agreed that these abuses were of a most serious nature, and must be ended.

Mr. LOWENTHAL. Would you regard such transactions as little pecadillos?

Mr. YOUNG. *No; I should say they were of major importance.*[19]

* * * * * * *

Senator TRUMAN. * * * I still say that the holding-company situation is going to be practically as bad when you get through with it as it was to start with.

Mr. YOUNG. On that point, Senator, I want to say that *I fully appreciate the evils that have been brought out here of the attenuated control, of the position that that control is in to milk properties,* and I have not attempted to say that there are not evils in railroads and evils in railroad holding companies just as there can be evils in any other business where there is unscrupulous management. * * *

I think the evils which you have very properly pointed out here can be eliminated in the future.[20]

But while Mr. Young declared "it is a bad thing for any individual to have such power" as pyramided holding companies gave him, and declared moreover that the improper transactions in the Alleghany system which he had acquired were "of major importance," he did not advocate legislation abolishing the holding companies of which he disapproved. He believed that legislation was not necessary to accomplish reform because he himself would complete the reforms, and do it more quickly than legislation possibly could.

[13] For discussion of Chesapeake & Ohio-Bremo Corporation-Chicago Great Western relations, see Hearings, Part IX, *passim*, and Report No. 25, Part 12, of this subcommittee, entitled: "Control of the Chicago Great Western—Bremo Corporation."

[14] Hearings, Part X, p. 4275. [Italics supplied.]

[15] For discussion, see Part IX, *passim*, and Report No. 25, Part 13, of this subcommittee, entitled: "Chicago Great Western Dividends."

[16] Hearings, Part X, p. 4275. [Italics supplied.]

[17] For discussion, see Hearings, Part VIII, pp. 2899 sqq., 2940 sqq., 2960 sqq., and Report No. 25, Part 5, of this subcommittee.

[18] Hearings, Part X, pp. 4275–4276. [Italics supplied.]

[19] Ibid., p. 4278. [Italics supplied.]

[20] Ibid., p. 4282. [Italics supplied.]

The CHAIRMAN. * * * In my judgment, this kind of thing has got to be stopped in the United States.

Mr. YOUNG. And we are probably going to beat you to it. * * *

* * * * * * *

The CHAIRMAN. I hope that if you do beat us to it, it will be upon a sound basis. And if you do, you cannot hurt my feelings by beating me to it, because all we want to do by passing legislation is to accomplish what you can accomplish without any legislation if you see fit to do so.[21]

In support of his argument that additional legislation was unnecessary, Mr. Young declared that the day was past when vast holding-company structures could be erected.

Mr. YOUNG. I wish to repeat that what came to birth in the Alleghany Corporation could never happen again.[22]

So far as Alleghany Corporation itself was concerned, Mr. Young insisted that under his management the corporation's policy would be enlightened. He vigorously denied, for example, that it would milk operating railroads like the Chesapeake & Ohio for the benefit of the holding company.

Mr. YOUNG. * * * For anyone to intimate or try to bring up into these hearings that the dividend policy of the Chesapeake & Ohio is going to be controlled for the benefit of that holding company is absolutely erroneous. There may have been managements in the past which have operated that way, but I can say emphatically that the present management will not operate that way, and the reason will be simply because we have sense enough to know that we cannot kill the goose that lays the golden egg. We are in this property to stay. We are not in it to milk the Chesapeake & Ohio overnight and get out. * * *[23]

Even if the control of Alleghany Corporation changed, Mr. Young declared the old abuses could not return, because of "public opinion."

Mr. YOUNG. I say that could be done, in the event that I should die and unscrupulous people came in and got control of the properties. They could do those things. I say they could within limitations. I have tried to make clear that they could not do it practically, because of the glare of public opinion; and I believe that even if an unscrupulous person came into my shoes tomorrow, he could not do these things actually. Theoretically he could, but actually he could not, because Mr. Marshall[23a] here and his friends in the Chesapeake & Ohio would rebel, and they would come down here and see Senator Wheeler and say, "These New York gamblers up there are trying to ruin our properties, and I think you had better give them a little investigation." I think that would stop it.[24]

Mr. Young believed that in addition to his own integrity and the power of public opinion, existing Federal laws, laws of the State of Maryland in which Alleghany Corporation is incorporated, and powers given by law to the Interstate Commerce Commission were sufficient to end such abuses.

Mr. YOUNG. I told Senator White yesterday, and I told Senator Wheeler that I felt that attenuation was bad, and that I felt that holding companies beyond the first degree were bad and that legislation is already such that it can never be repeated. * * *[25]

* * * * * * *

Mr. YOUNG. The laws of Maryland will prevent it and the Interstate Commerce Commission will prevent it.[26]

Finally, Mr. Young agreed that railroad operations should go back into the hands of railroad operating companies rather than be left in the hands of holding companies; indeed, he proposed to accomplish this himself.

Senator TRUMAN. * * * The sooner the railroads and the transportation companies, all of them, can be returned to the operating companies, the better it is going to be for the country. That is the whole reason for our labors here—to see if we cannot reach a conclusion that will permit railroad operation again to come back to the operators that ought to operate them, and take it out of the hands and the control of the New York bankers, or holding companies, if you please, and put it back where it ought to be. I am sure that in the long run you will agree with me.

Mr. YOUNG. I agree with you now. The only difference between us is the matter of the means to bring it about. *I say I can do it more quickly than it can be brought about by new legislation.* That, I think, would hinder it.[27]

Throughout his early testimony, Mr. Young gave a single impression—that the new holding-company management, realizing the evils of attenuated holding-company control of railroads, proposed to wipe out such attenuation as effectively and more quickly than Congress could do so by legislation. Mr. Young's testimony before the subcommittee indicated throughout that the pressing need for reform, and the right management to effect it, had at last come together.

BACKGROUND OF THE NEW MANAGEMENT'S PLAN FOR REFORM

On July 8, 1937, less than 6 weeks after Mr. Young had testified that "I can bring it about more quickly than it can be done by new legislation" the men in control of Alleghany brought forth a plan for reforming the corporate structure of the Alleghany system.[28] That plan, in the light of Mr. Young's testimony, is a test of the extent to which self-reform can be relied upon as the method of eliminating holding-company abuses. The reform management's plan, if it were sound and adequate, would support Mr. Young's thesis that legislation is unnecessary; if unsound or inadequate, it would indicate that measures going beyond self-reform are needed to end holding-company abuses in the railroad field.

Although the plan of reorganization was brought out just 6 weeks after the new management assumed control of the holding-company system, it was in no sense a hurried or thrown-together plan. Young, Kolbe & Co. had become interested in Alleghany as early as 1931.[29] Long before Mr. Young contemplated buying control of Alleghany on his own behalf, he and his associates, as investment brokers, had concerned themselves with various plans for the reorganization of Alleghany Corporation. As early as July 21, 1936, while Mr. O. P. Van Sweringen was still alive, Young, Kolbe & Co. had prepared for holders of Alleghany preferred stock a memorandum plan of reorganization[30] and had presented the plan to Mr. Van Sweringen.[31] Following his death[32] and the passage of control of Alleghany to Mr. George A. Ball,[33] Young, Kolbe & Co. had begun negotiations

[21] Hearings Part VII, pp. 2312-2313.
[22] Ibid., p. 2548.
[23] Hearings Part X, p. 4271.
[23a] R. S. Marshall, vice president and chief operating executive, Chesapeake & Ohio Railway Co.
[24] Ibid., p. 272.
[25] Idem.
[26] Hearings Part VII, p. 2569.
[27] Ibid., p. 2570.
[28] Their plan appears as Exhibit No. 1248, Hearings, Part X, pp. 4456-4475.
[29] Exhibit No. 465, Hearings, Part VII, p. 2601. (Memorandum dated December 28, 1936, from the files of White & Case, attorneys for Mr. Young. "Mr. Kolbe * * * stated that his company [Young, Kolbe & Co.] became interested in Alleghany Corporation about five years ago, and that he studied the matter carefully * * *.")
[30] This memorandum plan appears as Exhibit No. 455, Hearings, Part VII, pp. 2592-2594.
[31] Hearings, Part VII, p. 2351.
[32] Mr. O. P. Van Sweringen died on Nov. 23, 1936.
[33] The Van Sweringen holdings, pledged to J. P. Morgan & Co., and associated bankers, were sold at auction Sept. 30, 1935, to Mr. George A. Ball, glass-jar maker, of Muncie, Indiana, and associates. Mr. Ball left the brothers Van Sweringen in control, and gave them an option to purchase, which expired at the death of O. P. Van Sweringen on Nov. 23, 1936. Thereafter, Mr. Ball lodged control in the George & Frances Ball Foundation, which in turn sold the controlling block of Alleghany stock to the Young-Kolbe-Kirby syndicate on May 5, 1937. The syndicate assigned control to Young, Kolbe & Co. (For discussion, see Hearings, Part 1, and other reports of this subcommittee, in preparation.)

with the Ball interests, originally with a view to working out a plan of reorganization for them.[34] In December 1936 Mr. Ball requested Young, Kolbe & Co. to work out such a plan, which was done.[35] Thus the new management's plan of reorganization, dated July 8, 1937, was the outgrowth of a long period of study and conference.

In drafting the plan, Mr. Young called into consultation a wide range of well-known firms and experts in holding-company finance. Among those who assisted was John P. Murphy, secretary and treasurer of Alleghany Corporation and close associate of the Van Sweringens, active in the holding-company field since 1920. The attorneys who prepared the legal papers and thus participated in many of the decisions with respect to the plan were the New York firm of White & Case, attorneys for leading banks in the Morgan banking group, and from time to time counsel also for J. P. Morgan & Co. itself.[36] Tolles, Hogsett & Ginn (now Jones, Day, Cockley & Reavis), the Cleveland law firm which had helped to incorporate Alleghany Corporation and other Van Sweringen holding companies in the beginning, also participated.

Mr. Young did not at first confer with J. P. Morgan & Co.; indeed, he "rather studiously avoided" [37] them, because, as he put it, he did not want "too many cooks," [38] and because he "wanted to break the chain, you might say, of the old Van Sweringen line." [39]

After May 27, 1937, however, Mr. Young, Mr. Kolbe, or their attorneys had the benefit of repeated conferences with representatives or counsel of J. P. Morgan & Co., Guaranty Trust Co., Morgan, Stanley & Co., E. B. Smith & Co., and other large-scale financial firms and institutions.[40] Thus the program for self-reform of the Alleghany system was based on guidance from leading law firms and institutions.

Nor was the Young plan of July 8, 1937, a "trial balloon." It is true that Mr. Young considered it only one step in a larger program; but he was fully aware that a failure of this first step "might well lead to a failure of our future plans."[41] Said Mr. Young:

I wish we could move farther * * *;

but, he added,

* * * we have gone the full limit of what we deem we should go. * * * We have done the best we could with the materials we have had at hand * * *.[42]

[34] Hearings Part VII, p. 2352; Part X, p. 4086.
[35] Idem.
[36] Hearings Part VII, pp. 2341, 2354.
[37] Hearings Part X, p. 4090.
[38] Idem.
[39] Ibid, p. 4491.
[40] Ibid, pp. 4087 sqq. On Jan. 13, 1937, Mr. Young's lawyers discussed aspects of the plan with A. M. Anderson of J. P. Morgan & Co.; and on Jan. 21, they and Mr. Kolbe conferred with Mr. Anderson, and also with Mr. H. S. Sturgis of the First National Bank. (Exhibit No. 467, Hearings, Part VII, p. 2603; Exhibit No. 56, ibid, p. 2599.) See also Exhibit No. 456, ibid., p. 2594.
[41] Hearings Part X, p. 4290.
[42] Ibid, p. 4389.

II. THE PLAN AND THE PUBLIC INTEREST

CLAIM THAT PLAN WOULD ELIMINATE ALLEGHANY CORPORATION

The plan for self-reform of the holding-company system, as announced to security holders in letters dated July 8, 1937,[43] purported to be nothing less than the elimination of Alleghany Corporation from the American railroad scene. The plan was described as "the consolidation of Alleghany Corporation and The Chesapeake Corporation into a new corporation to be known as Chesapeake Corporation."[44] One stated purpose was "to eliminate one of the foregoing holding companies * * *."[45] Alleghany bondholders were informed that "*Alleghany Corporation will be eliminated by the consolidation.*"[46] Stockholders were told:

> The board of directors of your company believes that the elimination of the last of the top holding companies of the Van Sweringen interests, the simplification of capital structures, and the other results of the consolidation will be to your advantage.[47]

The elimination of Alleghany Corporation was an event of major importance to the financial community, widely commented on by financial services and newspapers. *Poor's Investment Service* declared:

> * * * The proposal is intended to eliminate Alleghany Corporation, which is in great disfavor because of its past financial practices, its tremendous capitalization, and its vulnerability under any railroad holding company legislation. * * *[48]

The *New York Times* stated:

> In removing Alleghany Corporation from the field of going concerns, the new owners will end the history of an agency which, from its formation in January, 1929, at the peak of the inflation, aroused the attention of Wall Street and Washington.[49]

But while holding-company officials were telling bondholders that "Alleghany Corporation will be eliminated," the plan proposed nothing of the sort. Their proposal was actually for the elimination of The Chesapeake Corporation, an intermediate and far less notorious holding company, whose chief or only function was to hold stock in the Chesapeake & Ohio Railway Co. The elimination of Alleghany Corporation, which the reform management claimed to be accomplishing, would have been a major reform indeed. The elimination of The Chesapeake Corporation, which was actually being accomplished, was a mere detail in simplifying the corporate maze which Mr. Young controlled.

The plan changed the name of the top holding company from "Alleghany Corporation" to "Chesapeake Corporation." But it did

[43] Exhibits No. 1250–A–E, ibid., pp. 4493–4499.
[44] Exhibit No. 1250–A, ibid., p. 4493.
[45] Idem.
[46] Idem. [Italics supplied.]
[47] Exhibits No. 1250 B, C, and D, pp. 4494 at p. 4495; 4495 at 4496; 4497.
[48] Exhibit No. 1282, ibid., p. 4532 at p. 4533.
[49] The *New York Times* for July 9, 1937, p. 25.

not change the essential nature of the corporation. The new corporation, like the old, would have three bond issues, two classes of preferred stock, and one class of common.[50] It would have the same directors,[51] would own essentially the same securities,[52] would be controlled by the same interests,[53] would be liable to the same and additional[54] abuses. Alleghany Corporation was to be retained, but to be rechristened "Chesapeake Corporation," in memory of the comparatively esteemed and innocuous "The Chesapeake Corporation" which would actually be eliminated.

The idea of changing the name of Alleghany Corporation and then claiming that the corporation itself was being eliminated was of comparatively late date. Prior to assumption of control by the Young syndicate, they freely admitted that their aim was to eliminate The Chesapeake Corporation. On May 5, 1937, the day they assumed control, Mr. Young and his associates issued a statement to the press to this effect:

* * * Attention will next be given to the elimination of The Chesapeake Corporation.[55]

* * * Messrs. Young, Kolbe, and Bradley have been constituted a subcommittee of the board of directors with authority to formulate a definite plan looking toward *the elimination of The Chesapeake Corporation* by merger or consolidation with Alleghany Corporation or otherwise.[56] * * *

The following day Mr. Young told this subcommittee:

Mr. Kolbe and I went on the board of *The Chesapeake Corporation* * * * because we have very definite plans *for its elimination* at a very early date.[57]

Sometime thereafter[58] some lawyer, financier, or official in the reform group must have evolved the thought that, in addition to eliminating The Chesapeake Corporation, it would be wise to eliminate the *name* of Alleghany Corporation. This step became the basis for the claim that they were eliminating the corporation itself.

At hearings before this subcommittee subsequent to publication of his plan, Mr. Young made no attempt to justify his claim that Alleghany was being eliminated: he admitted that Alleghany was in fact being "reorganized."

Mr. KAPLAN. Is it not also true, as a general observation, that this plan is basically a reorganization of Alleghany?

Mr. YOUNG. *I should not say that it basically goes very much further than that.*[59]

A month after the plan was made public, attorneys for the new Alleghany management acknowledged to a Baltimore court that one purpose of the plan was "the elimination of [The] Chesapeake Corporation"[60] rather than Alleghany Corporation.

Had the reformers carried out their expressed wish of beating the Congress of the United States to the task of reforming this holding-company system, they might indeed have striven to eliminate Alleghany Corporation, whose sorry record they knew and deprecated. This they did not do; instead, they proposed to eliminate the *name*, and to retain the substance under a new corporate title.

In a release to the press prior to hearings before this subcommittee on August 5, 1937, the holding-company management made a similar terminological expedition. They took a copy of a chart[61] prepared by this subcommittee, showing the intricate corporate relationships between the 19 topmost holding companies in the old Van Sweringen system and the balance of the 200-company empire, crossed out with heavy black lines all 19 of the topmost holding companies, and wrote in the margin: "All companies within jagged lines will have been segregated or eliminated on completion of the Alleghany Corporation-Chesapeake Corporation merger."[62]

The fact is that not a single one of these 19 companies would be "segregated or eliminated" by the Alleghany-Chesapeake merger. Eighteen of them had been "segregated or eliminated" prior to or at the time when the new management assumed control;[63] the nineteenth, Alleghany Corporation, would continue in reorganized form after the merger.[64]

CLAIM THAT REORGANIZED COMPANY WOULD BE A FIRST-DEGREE HOLDING COMPANY

The Chesapeake Corporation, the only company which would actually be eliminated by the merger, was not crossed out on the management's chart. It was circled, and in the margin was written: "The Chesapeake Corporation will become a first-degree holding corporation."[65]

Alleghany officials desired that the merged corporation would be accepted as a first-degree holding company. They knew that the act of Congress regulating or eliminating holding companies in the public-utility field had made many exceptions in favor of first-degree holding companies.[66] Mr. Young had previously testified that he thought first-degree holding companies in the railroad field were not as liable to abuses as holding companies of a higher degree.

Yet the record shows that Mr. Young was at least dubious about the propriety of dubbing the emerging corporation "a first-degree holding company." Two weeks before hearings on the plan by this subcommittee began, he had written to his attorney:

Do you think it is too much of a poet's license to call the Chesapeake Corporation, a first-degree holding company as I have on the photostat chart?[67]

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[50] Hearings, Part X, pp. 4112 sqq.

[51] For 1937 Alleghany directors, see Moody's *Steam Railroads* (1937) p. 1802; for proposed new directors see Exhibit No. 1249, Hearings, Part X, p. 4476 at p. 4478.

[52] Except for changes in C. & O. and Chesapeake Corporation stock holdings. Compare balance sheet in Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4469 with balance sheet in ibid. at pp. 4473–4475.

[53] For effect of the plan upon control, see Exhibit No. 1265, Hearings, Part X, p. 4506, discussed at pp. 4110–4111. See also below, pp. 10–12.

[54] See below, pp. 12–14.

[55] Exhibit No. 481, Hearings, Part VII, p. 2630.

[56] Ibid., at p. 2631. [Italics supplied.]

[57] Ibid., pp. 2308–2309.

[58] But prior to May 27, 1937, when Mr. Young informed reporters that he was merging Alleghany Corporation into The Chesapeake Corporation instead of *vice versa* because "Chesapeake" was a better name. (*Wall Street Journal* May 27, 1937, pp. 1 and 4).

[59] Hearings, Part X, p. 4111.

[60] Exhibit No. 1344–B, ibid., p. 4608 at p. 4609.

[61] Exhibit No. 5, Hearings, Part I, facing p. 216.

[62] Exhibit No. 1263, Hearings, Part X, facing p. 4505.

[63] Control of Alleghany Corporation and of 17 other Van Sweringen holding companies had been vested in a superholding company, Midamerica Corporation. The "segregation" resulted at the time that the Young-Kolbe-Kirby syndicate bought Alleghany securities. (Exhibit No. 479, Hearings, Part VII, pp. 2628–2629.) For discussion, see Hearings, Part X, pp. 4105–4106; also Hearings, Part VII, pp. 2370 sqq and exhibits there cited.

[64] Although the legal title of the proposed company under the proposed plan would be "Chesapeake Corporation," it will sometimes hereinafter be referred to as "The reorganized Alleghany Corporation," a less confusing descriptive title.

[65] Exhibit No. 1263, Hearings, Part X, facing p. 4505.

[66] Mr. LOWENTHAL. But you will still have a holding company, will you not, in control?

Mr. YOUNG. A direct first-degree holding company, which I understand, in the light of the administration attitude toward utility holding companies, and also as to railroad holding companies, is not obnoxious—first-degree holding companies. (Hearings, Part VII, p. 2537.) See also Hearings, Part X, p. 4107, and Exhibit No. 1330, Hearings, Part X, p. 4571.

Mr. KAPLAN. You are seeking, by calling this a first-degree holding company, to take advantage of an analogy to the Public Utility Holding Company Act?

Mr. YOUNG. We hope that that will be the effect of it. (Hearings, Part X, p. 4108.)

[67] Exhibit No. 1264, Hearings, Part X, p. 4506.

Mr. Young testified that the attorney replied that it was not "too much of a poet's license." [68]

The chairman commented on the statement that the new company would be a first-degree holding company: [69]

The CHAIRMAN. Oh, no. You have stated that, but it is not true, because of the fact The Chesapeake Corporation will not become a first-degree holding company. The Chesapeake Corporation will control the C. & O., the first subsidiary; * * * the Chesapeake & Ohio in turn controls the Virginia Transportation Corporation, a second subsidiary, and the Virginia Transportation Corporation controls the Standard Car Loading Corporation, a third subsidiary, and the Standard Car Loading Corporation controls the National Car Loading Corporation, a fourth subsidiary, and the National Car Loading Corporation controls the Judson Freight Forwarding Company * * *.[70]

ATTENUATED CONTROL OF THE HOLDING COMPANY NOT ELIMINATED

Mr. Young's control of the entire Alleghany system of corporations rested on an admittedly unsound basis. The total public investment in these companies was thousands of times as large as his investment;[71] yet control was lodged in his hands. Even in Alleghany Corporation and The Chesapeake Corporation, the two holding companies which were to be consolidated, the equity owned by the public, senior to Mr. Young's common stock, was some 700 times larger in amount than his investment in that common stock.[72]

In the hearings before the subcommittee on his plan, as in the hearings on his purchase of control, Mr. Young repeatedly acknowledged that control of a vast empire, on an investment in common stock of $255,000 (the amount he invested), is unsound from the general, as well as from the investors' point of view.

The CHAIRMAN. No matter how good you may be—and I am not questioning that—you, a man who has never had any railroad experience, have the power to take railroad executives and railroad directors and railroad officers and move them about like pawns upon a chess board, or do whatever you want to do with these various railroads.

Mr. YOUNG. You are right.[73]

* * * * * * *

The CHAIRMAN. * * * It is an evil of the holding-company system?

Mr. YOUNG. The evil, as I see it, is having a situation develop where a man with $255,000 can gain control of all these things. That is correct.[74] * * *

* * * *The control of a huge amount of assets, with small investment, is necessarily an evil.* * * * [75]

The evil of control of the Alleghany system by means of a shoestring investment was aggravated in this case because control of the huge system was held through holding-company common stock which had *no* asset value.[76] The management's holdings of Alleghany common had a value because they could control the system, not because the stock reflected any property or assets. As a Baltimore court which considered this reorganization plan put it: "Alleghany common has no asset, only a strategic value." [77]

Common stock having such a position can use its power to oppress the security holders who really have a property interest in the company; the temptation is a powerful one. The stockholders can, for example, cause the company to engage in stock-market speculation, knowing full well that speculative profits will give value to their otherwise worthless stock, while speculative losses will be borne entirely by holders of securities senior to their stock.

Mr. Young himself acknowledged to the subcommittee:

The common stock today is in the position of having all the possible benefits of this company with none of its disadvantages.[78]

Two months later, when the holding-company management issued its plan to reorganize Alleghany it had an opportunity to correct what Mr. Young had so severely criticized. It could, by appropriate provisions, have proposed that security holders of Alleghany who truly own its assets should control the holding company. It could have gone further in reform, and proposed that the holding company should not exercise control over the network of railroads; that, instead, the railroads should be controlled by the operating-company investors who had a far larger interest in the transportation property than the holding companies.

The plan contained no such proposals. On the contrary, it was calculated to insure the management's control of both the operating railroad companies and the holding company itself.[79] True, control would be based on 33 percent of the holding company common stock, rather than as previously, on 43 percent,[80] but the change in percentage would not change the result.

The plan did not say Mr. Young would control the whole system on a minute fraction of the total investment in all these companies. But the fact that he would have such control was elicited at the subcommittee's hearings.

Mr. KAPLAN. In the same sense in which you are now in control of Alleghany, will you continue to be in control of the new company?

Mr. YOUNG. I hope so.

Mr. KAPLAN. You know so.

Mr. YOUNG. Well, many things can happen.

Mr. KAPLAN. If your plan is consummated.

Mr. YOUNG. If the plan is consummated and I live and nothing happens, we will control the new company, by a considerably lesser potential percentage than we do today.[81]

* * * * * * *

Mr. KAPLAN. So that, for some period of time, you will continue to have a 33-percent control?

Mr. YOUNG. An indefinite period of time.

Mr. KAPLAN. * * * You do not dispute that 33 percent will be effective working control of the entire situation?

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[68] Hearings, Part X, p. 4107.
[69] Hearings, Part X, p. 4106.
[70] Other examples: In relation to the Chicago & Eastern Illinois and in part the Erie and Nickel Plate, the reorganized Alleghany Corporation would be a third-degree holding company. Again, the reorganized Alleghany Corporation would control the Superior Transfer Co. of Delaware through various parallel lines of stock ownership involving 11 intermediate companies. (Exhibit No. 5, Hearings, Part I, facing p. 216.)
[71] The grand total of stocks, bonds, and notes outstanding of Alleghany Corporation's operating subsidiaries (exclusive of purely holding companies like The Chesapeake Corporation, Virginia Transportation Co., etc.) was $2,082,332,524. (Exhibit No. 8, Hearings, Part I, p. 222 at p. 225.) Mr. Young's personal investment in the controlling block of Alleghany common stock totalled less than $255,000 (see above, pp. 1, 2, and footnote 7 thereto).
[72]

Publicly owned equity in capital and surplus of The Chesapeake Corporation (exclusive of portion owned by Alleghany Corp.)	$29,656,703
Alleghany bonds at par	77,791,000
Alleghany preferred and prior preferred	67,846,320
Total public equity in Chesapeake & Alleghany senior to Mr. Young's $255,000 investment in controlling common stock	$175,294,023

(Exhibit No. 1248, Hearings, Part X, p. 4456 at pp. 4467–4473.)
[73] Hearings, Part X, p. 4112.
[74] Ibid., pp. 4071–4072.
[75] Ibid., p. 4074.

[76] As of June 30, 1937 (the date taken by the reorganizers for their examples), Alleghany common had a *deficit* asset position of $82,383,001.29 (Exhibit No. 1276, Hearings, Part X, p. 4512 at p. 4513), or $18.55 per share.
[77] Exhibit No. 1342, Hearings, Part X, p. 4584 at p. 4591.
[78] Hearings, Part X, p. 4140.
[79] Mr. KAPLAN. And you will continue to have that power, even if your plan goes through?
Mr. YOUNG. Correct. (Hearings, Part X, p. 4112.)
[80] Exhibit No. 1265, Hearings, Part X, p. 4506.
[81] Hearings, Part X, p. 4110.

Mr. YOUNG. We hope it will be.
Mr. KAPLAN. You are confident it will be?
Mr. YOUNG. Yes.[82]

There can be no doubt that 33 percent of the common stock could control the reorganized Alleghany Corporation. Mr. Young's partner, Mr. Kolbe, writing to an associate of Mr. Ball, had assured him that 25 percent would be "ample control";[83] and had later written to J. P. Morgan & Co. that "anything above 15 percent should, for all practical purposes, control the company."[84]

It is thus clear that the plan did not attempt correction of the financial malady Mr. Young deplored when he appeared before the subcommittee—attenuated control by one or two individuals. Under the plan, the malady would be continued in all its virulence.

Mr. KAPLAN. There will be control of the company by securities having a deficit position.
Mr. YOUNG. That is correct.[85]

Mr. Young had said: "The control of a huge amount of assets, with small investment, is necessarily an evil."[86] The plan prepared by Mr. Young and his financial and legal advisers proposed not even a first step toward removing that evil.

PLAN WOULD INCREASE POWERS OF ALLEGHANY CONTROLLERS

When the Van Sweringens had first caused Alleghany Corporation to be incorporated in 1929, they had secured for that corporation the broadest powers. It was empowered to—

> acquire by purchase, subscription, or otherwise, and to own, hold for investment, to use, sell, assign, transfer, mortgage, pledge, exchange, or otherwise dispose of, shares of stock, bonds, debentures, notes, scrip, securities, evidences of indebtedness, contracts, or obligations, of any corporation * * * [etc.][87]

Alleghany Corporation was further empowered—

> to borrow or raise money without limit, and upon any terms, for any purpose of the corporation or of any corporation, association, firm, syndicate, or individual having a business or property which the corporation determines to finance, promote, or become interested in; to issue, sell, and dispose of the corporation's bonds, debentures, notes, certificates of indebtedness and other obligations, secured or unsecured and however evidenced, upon any terms, and as security therefor to mortgage, pledge, or grant any charge or impose any lien upon all or any part of the real or personal property, rights, interests, or franchises of the corporation, whether owned by it at the time or thereafter acquired.[88]

A full enumeration of the powers granted to Alleghany Corporation would require two pages of this report; yet it was expressly provided that the enumeration is "in furtherance and not in limitation of the general powers conferred by the laws of the State * * *"[89] and that the vast powers specifically granted "shall not be held to limit or restrict in any manner the powers of the corporation."[90]

Mr. Young, as has been noted, frankly admitted the abuses which would follow from the establishment of holding companies with such powers. He had assured this subcommittee that "what came to

[82] Ibid., pp. 4110–4111.
[83] Exhibit No. 458, Hearings, Part VII, p. 2598.
[84] Exhibit No. 456, Ibid., p. 2594 at p. 2597.
[85] Hearings, Part X, p. 4157.
[86] Ibid., p. 4074. See above, p. 10.
[87] Exhibit No. 83, Hearings, Part I, pp. 387–388.
[88] Ibid., at p. 388.
[89] Idem.
[90] Ibid., at p. 389.

birth in the Alleghany Corporation could never happen again."[91] Yet the reorganized company was to have as great corporate powers as had been granted to Alleghany Corporation in 1929. The reform management was, in short, proposing to bring to birth another Alleghany Corporation.

Chairman Wheeler commented on these broad powers:

> In other words, you can buy bonds or stocks, and speculate all over the world; you can buy and sell on margin, and so on, under this charter, if you see fit to do so. Here you are controlling 23,000 miles of railroads, and the securities of 23,000 miles of railroads, and you can play with them as you may see fit, or pledge them as security to anyone.[92]
>
> * * * * * * *
>
> In other words, you want to have absolute power to use these for speculative purposes or for any other purpose you may see fit. You want people to put money into your hands, to invest their money so to speak, and to trust implicitly in your judgment, to the end that you may speculate with it in any way, shape, or form you may see fit.[93]

Far from reducing the power which would be theirs by virtue of control of Alleghany, Mr. Young's group proposed to increase that power by removing one major limitation which had been written into the old charter.

Alleghany's original charter provided that, without the approval of holders of a majority of the preferred stock, the corporation could issue no additional preferred stock and could not go into debt unless it had assets of $100 for every $60 of preferred stock and debt outstanding.[94] This 60-percent margin limitation was written into the charter at the instance of the Guaranty Co., head of the syndicate which sold the stock, and was designed to protect investors.[95] The bankers had made much of this safeguard when they sold Alleghany preferred stock to investors.[95a] This charter limitation, the plan proposed to remove.

The letter which company officials sent holders of preferred stock to explain the plan did not call attention to the removal of this protection.[96] The protecting clause was simply to be eliminated without comment.[97]

Mr. Young defended the removal of this limitation on his power on the ground that it was a "freak" provision.

> Mr. YOUNG (continuing). I testified yesterday that Alleghany was a freak company, and it is a freak in those very particulars.
> The CHAIRMAN. Well, this is a freak company, it would seem to me, if you are going to permit the board of directors to accept and use the money of investors to speculate with in any way, shape, or form they see fit.[98]

Mr. Young stated that the plan would in fact remove the opportunity for speculating with other people's money, since one of its features would be to bring the free assets of The Chesapeake Corporation under the mortgage indentures governing Alleghany's bonds,[99]

[91] Hearings, Part VII, p. 2548. See above, p. 4.
[92] Hearings, Part X, p. 4103.
[93] Ibid., p. 4104.
[94] Article Sixth, paragraph (f) of Alleghany's charter, (Exhibit No. 83, Hearings, Part I, p. 387 at pp. 391–392.)
[95] Hearings, Part II, pp. 454–455.
[95a] Hearings, Part II, p. 478; Part I, pp. 416, 421, 426.
[96] Exhibit No. 1250–C, Hearings, Part X, pp. 4495–4496.
[97] Compare Article Sixth, Paragraph (f) of Alleghany's original charter, cited in footnote 94 above, with the proposed "Plan of Consolidation," Exhibit No. 1249, Hearings, Part X, pp. 4476–4489, esp. at pp. 4480–4482.
[98] Hearings, Part X, p. 4102.
[99] Ibid., p. 4103, 4104.

where they could not be used for speculative purposes. But (*a*) all the "free" collateral referred to would not necessarily be so pledged: [1] (*b* the plan proposed to minimize or perhaps to abolish the bonds outstanding under one of the three indentures; [2] (*c*) Mr. Young testified that he hoped soon to wipe out the limitations set by the other two indentures; it was "the next step we have in mind;" [3] and (*d*) the indentures were themselves not complete protection, since they permitted "switching" and substitution of one security for another.[4] In short, the plan contained no guaranty that assets taken from The Chesapeake Corporation would not be wasted in the ways in which previous Alleghany assets had been wasted.

The new Alleghany management had excellent reason for wishing to broaden its power by removing the 60-percent margin limitation. It proposed to use the additional power immediately. The plan itself would burden the proposed new holding company, at the moment of its formation, with debt and preferred stock $100,000,000 greater than would have been possible had the 60-percent limitation been retained.[5]

DIRECTORATE AND MANAGEMENT OF THE REORGANIZED COMPANY.—(CONTINUITY WITH VAN SWERINGEN DIRECTORATE AND MANAGEMENT

In preparing the plan for the reform of Alleghany Corporation, the reformers could have ended what Mr. Young himself termed "the evils * * * of attenuated control." [6] This the new management did not do. Short of such a step, it might have surrounded itself with directors and executives who would see that the vast power given it in the reorganized holding company would not be abused. The managers of the holding company might have made sure that the men on whom it would have to rely, first for advice and suggestions, later for the execution of decisions, and finally for the exercise of discretion, were men equipped with the personality, the courage, the understanding, and the ability necessary to prevent recurrence of the old abuses.

To find men of the requisite character, the new holding-company management might have gone outside the Van Sweringen system, especially since Mr. Young was avowedly anxious "to break the chain, you might say, of the old Van Sweringen line." [7] Any real effort to "break the chain" might have involved changes in the personnel of major companies in his holding-company system—companies wrecked by past management, as the following brief summary indicates:

[1] The reorganization plan originally had provided for pledging only enough C. & O. stock under the mortgage indentures to equal the market value of the Chesapeake stock which would be cancelled under the plan; but Guaranty Trust Co., as trustee under the indenture, had insisted that Alleghany bondholders receive a full 1½ shares of C. & O. as collateral. (Hearings, Part X, pp. 4123-4124.) Even though the C. & O. common remained under the indenture, however, this might free *other* collateral, which Mr. Young proposed, if necessary, to transfer. (Hearings, Part X, p. 4113.)

[2] One stated purpose of the plan was "the retirement of the outstanding [5's of 1950] * * * either in whole or in part." (Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4457.)

[3] Hearings, Part X, p. 4124.

[4] Ibid., p. 4127.

[5] Ibid., p. 4105.

[6] Ibid., p. 4282.

[7] Ibid., p. 4091.

Vaness Co.—Used as superholding company to control Alleghany;[8] milked the railroads it controlled;[9] speculated on the stock market;[10] unloaded large quantities of Alleghany common stock on another of the holding companies at $1,200,000 above the market price [11] (a deal which one of the bankers confessed was so bad that it shocked him);[12] liable on a $40,000,000 bank loan it cannot pay;[13] hopelessly insolvent.[14]

Van Sweringen Corporation.—Used as an intermediate holding company between Vaness and Alleghany;[15] got $30,000,000 from investors,[16] lost half of it in speculation;[17] so hopelessly insolvent that Mr. Ball sold over $13,000,000 of its bonds and more than 1,000,000 shares of its stock to Mr. Young for less than $1 for the entire lot.[18]

Cleveland Terminals Building Co.—Intermediate between Van Sweringen Corporation and Alleghany;[19] siphoned from Van Sweringen Corporation much of the money invested by the public,[20] engaged in wild speculation on the stock market; [21] insolvent.[22]

Alleghany Corporation.—Put $100,000,000 into a campaign to buy Missouri Pacific securities,[23] lost most of it,[24] has already been once

[8] There were in fact two Vaness Companies, one incorporated in Delaware and one in Maryland. The Vaness Co. of Maryland was created simply to hold the stock of the Vaness Co. of Delaware. (Hearings, Part XI, pp. 4742-4747.) The Vaness Co. of Delaware in turn held stock of the Van Sweringen Corporation, which held the controlling block of Alleghany stock until that stock was sold at auction to George A. Ball and associates Sept. 30, 1935.

[9] From 1928 through March 1934, the Vaness Co. (Delaware) levied charges totaling $875,688.45 against Allaghany-controlled railroads. (*Investigation of Railroad financing*, Hearings before the Senate Committee on Interstate Commerce on S. Res. 71, 74th Cong., 1st sess., March 20-27, 1935, p. 149.) For discussion, see Report No. 25, Part 8, of this subcommittee, entitled, "Alleghany Corporation: Acquisition of Missouri Pacific Railroad—Devices Used to Secure Consent of Missouri Public Service Commission," pp. 16-17.

[10] Hearings, Part IV, *passim*, esp. Exhibit No. 321, ibid., p. 1381; Exhibit No. 324, ibid., p. 1582; Exhibit No. 343, ibid., p. 1595.

[11] On October 7, 1930, the Cleveland Terminals Building Co., a publicly financed Van Sweringen holding company, bought 609,009 shares of Alleghany common from the Van Sweringens' "personal basket," Vaness Company, at $20 per share (Exhibit No. 326, Hearings, Part IV, p. 1583). The highest New York Stock Exchange quotation on that day was $18.00 (*Commercial & Financial Chronicle*, Vol. 131, Part II, p. 2346). The price paid by the publicly financed holding company to the privately owned holding company was $1,200,000 in excess of the closing market price on that date. (Hearings, Part IV, pp. 1324-1325.) The effect was to saddle the Van Sweringens' speculative losses, incurred through the Vaness Co., on investors in Van Sweringen Corp. (see below).

[12] "I was very shocked at what you described here yesterday." William C. Potter, chairman of the board of Guaranty Trust Co. of N. Y. (Hearings, Part IV, p. 1387.)

[13] As of Sept. 25, 1935, the Vaness Co. owed the bankers $18,250,000 and the Cleveland Terminals Building Co. owed the bankers $22,019,932.10 (Exhibit No. 22, Hearings, Part I, p. 235). The Vaness Co. was liable on the Cleveland Terminals Building Co. loan as well as on its own. (Exhibit No. 3, Hearings, Part I, p. 201, at p. 214.) The collateral pledged for this loan was sold at auction Sept. 30, 1935, for $4,703,000 (N. Y. *Times*, October 1, 1935, p. 1). The balance of the loan was long since written off by the banks. (Ibid.; also Exhibit No. 39, Hearings, Part I, p. 251, at p. 255, footnote 3.)

[14] Idem.

[15] Exhibit No. 5, Hearings, Part I, facing p. 216; also Exhibit No. 24, ibid., facing p. 237.

[16] On notes sold through Guaranty Co., of N. Y., April 24, 1930 (Hearings, Part IV, p. 1246).

[17] On October 29, 1931, an offer was made to redeem the notes sold less than 18 months before, for 50 percent cash and the balance Van Sweringen Corp. common stock. (Exhibit No. 433, Hearings, Part VI, pp. 2242-2243.) The stock is, of course, worthless (see note 18 below) and was practically worthless when offered. (Exhibit No. 435, Hearings, Part VI, p. 2250.)

[18] For $1.00 Mr. Young bought on May 5, 1935, 93.67 percent of 1,241,580 shares of Van Sweringen Corp. common, and the same percentage of $18,136,501.85 of Van Sweringen Corp. debt, and of sundry other "securities" (Exhibit No. 448, Hearings, Part VII, pp. 2582-2583) from the Ball interests, who had valued the 1,241,580 shares of common stock at $1.00 and the $18,136,501.85 of debt at 80¢ as of Sept. 30, 1935 (Exhibit No. 2, Hearings, Part I, p. 200). For fuller accounts of the Van Sweringen Corporation, see other reports of this subcommittee, in preparation.

[19] Exhibit No. 5, Hearings, Part I, facing p. 216; also Exhibit No. 24, ibid., facing p. 237.

[20] Van Sweringen Corp., borrowed $30,000,000 from the public on the strength of the protective clauses in its note issue; then lent $29,415,624.79 on open account to Cleveland Terminals Building Co. (Exhibit No. 310, Hearings, Part IV, p. 1565), which was free to speculate with it. (Hearings, Part IV, p. 1329 sqq.)

[21] Exhibits Nos. 320, 322, 326, 327, 329, etc., Hearings, Part IV, pp. 1580-1586.

[22] For demonstration of insolvency as early as Sept. 30, 1931, see Exhibit No. 436, Hearings, Part VI, p. 2250. Midland Corporation valued 17,000 shares of C. T. B. Co. stock at $1.00, $1,200,000 of its bonds at $2.00, and $207,176.60 of its notes at $1.00, as of Sept. 30, 1935 (Exhibit No. 2, Hearings, Part I, p. 200). These securities were sold to the Young-Kirby-Kolbe syndicate for less than $1.00 for the lot on May 5, 1937 (Exhibit No. 448, Hearings, Part VII, p. 2582-2583).

[23] See Hearings, Part XI, *passim*, esp. Exhibit No. 1355, ibid., pp. 4777-4780, and Report No. 25, Part 8, of this subcommittee.

[24] Missouri Pacific securities purchased for $79,690,013.04 had an indicated market value of $4,242,115 on June 30, 1937, the date taken by the reform group for their examples (Exhibit No. 1249, Hearings, Part X, p. 4476 at p. 4489).

through the Federal bankruptcy court,[26] has milked the railroads,[26] played fast and loose with Government regulation,[27] used railroads to defraud the Government.[28]

Missouri Pacific Railroad Co.—Falsified its books, [29] made fraudulent applications to the Government,[30] hoodwinked the Interstate Commerce Commission,[31] speculated in its own securities,[32] reported income it did not truly earn,[33] forced subsidiaries to pay to it dividends they did not earn,[34] and lent money to the biggest of them to enable payment of unearned dividends.[35] Both Missouri Pacific and a number of its larger subsidiaries are now in the hands of the Federal bankruptcy court.[36]

With this record of wrecked holding and operating companies (there is much more of a similar nature) before them, the new controllers of Alleghany chose their officers from among the very group which had been running the holding companies during the period of past abuses. As president of Alleghany Corporation, for example, they chose a man [37] who had been the treasurer, and a director, of Vanness Co., the first of the holding companies just mentioned, as well as president and director of Cleveland Terminals Building Co., the third of these companies, and vice president and a director of Alleghany Corporation, the fourth of them.[38] As treasurer of Alleghany, they retained the man [39] who had held that post and had been an Alleghany director since the corporation's creation, and who was also a director and executive committee member of the Missouri Pacific Railroad Co., and a director of a Missouri Pacific subsidiary which the latter company milked.[40] He was one of five Missouri Pacific directors charged with fraud in connection with the notorious purchase by the Missouri Pacific of its own securities.[41]

[25] Hearings, Part VI, p. 2134.

[26] For details of the transaction by which Alleghany unloaded upon the Chesapeake & Ohio Railway Co., for $5,573,675 stocks having an indicated market value at the date of sale some $1,750,000 less than the contract price, see Hearings, Part VII, pp. 2269 sqq.) and reports of this subcommittee in preparation. For details of the so-called "Terminal Shares transaction" by which Alleghany Corporation unloaded certain terminal properties on the Missouri Pacific Railroad Co., at what a court later declared to be an "exorbitant" price, which "had the effect to saddle upon debtor [Missouri Pacific] an immense loss already sustained by Alleghany Corporation," (Exhibit No 119, Hearings, Part II, p. 683 at pp. 684-685), see Hearings, Part II and III, *passim*, and reports of this subcommittee, in preparation.

[27] See, by way of example, accounts of the use of Alleghany Corporation to bring noncompeting railroads under common control without permission of the Interstate Commerce Commission, in spite of the Transportation Act of 1920, in Hearings, Part XI, pp. 4663-4698, pp. 4747-4749, and Report No. 1182 of this subcommittee, entitled "Railroad Combination in the Eastern Region." Parts 4 and 5. For an account of the purchase by Alleghany Corporation of more than 10 percent of the stock of the Kansas City Southern, without the permission of the Missouri Public Service Commission, in apparent violation of Revised Statutes of the State of Missouri (1929) Sec. 5177, see Hearings, Part IX, pp. 3515-3516, and *passim*; see also Report No. 25, Part 15.

[28] For an account of the loan fraudulently procured by the Chicago & Eastern Illinois from the Reconstruction Finance Corp., see Hearings, Part VIII, pp. 2682 sqq., and Report No. 25, Part 5. For an account of the loan procured by the Missouri Pacific from the Reconstruction Finance Corporation through false statements, see Hearings, Part III, pp. 1110-1134 and reports of this subcommittee, in preparation.

[29] Hearings, Part XII, *passim*, and Report No. 25, Part 11, of this subcommittee.

[30] Hearings, Part XII, p. 5141 sqq., and a report of this subcommittee in preparation, dealing with concealment of the Terminal Shares transaction from the Interstate Commerce Commission.

[31] Idem.

[32] Hearings, Part XII, p. 5031 sqq., and Report No. 25, Part 11.

[33] See Report No. 25, Part 3, of this subcommittee, entitled "Fallibility of Auditors' Certificates: Inadequacy of Price, Waterhouse & Co.'s Certificate to Missouri Pacific Stockholders." See also Report No. 25, Part 9, "Missouri Pacific System: Intercompany Dividends and Advances—1926-1931."

[34] Hearings, Part XII, p. 5222 sqq. See also Report No. 25, Part 6, "Missouri Pacific System: Intercompany Dividends and Advances—1926-1931."

[35] Idem.

[36] For discussion of the Missouri Pacific bankruptcy see Report No. 25, Part 2, of this subcommittee.

[37] Moody's *Steam Railroads* (1937), p. 1892.

[38] For a full list of the 9 Van Sweringen companies of which he was an official and director, see Hearings, Part XIII, p. 5731; see also ibid., pp. 5754 et seq.; also Exhibit No. 1341, Hearings, Part X, p. 4582 at p. 4583.

[39] Moody's *Steam Railroads* (1937), p. 1802; Exhibit No. 1341, Hearings, Part X, p. 4582 at p. 4583. He was a director or official of 14 Van Sweringen corporations. (Idem.)

[40] The New Orleans, Texas & Mexico. See Hearings, Part XII, pp. 5222 sqq. and Report No. 25, Part 9, of this subcommittee, entitled "Missouri Pacific System: Intercompany Dividends and Advances."

[41] Hearings, Part XIV, p. 6063.

The Young syndicate retained as secretary of Alleghany a lawyer who had held that position since the company was founded,[42] and who had also been secretary and a director of Van Sweringen Corporation[43]—the holding company in which the public lost half its $30,000,000 investment within 18 months after it was started.

Among the directors who were chosen the day the reformers took control and whom they proposed to continue in office as directors of the reorganized corporation were the president, above-mentioned; [44] a partner in the law firm of Tolles, Hogsett & Ginn,[45] attorneys for the above-mentioned holding companies for years;[46] and a director of Missouri Pacific Railroad Co.[47] and of the subsidiary railroad it milked,[48] also charged with fraud in connection with the purchase by the Missouri Pacific of its own securities.[49]

Mr. Young took few important steps in preparing the financial phases of the plan without consulting one or more of the directors and officers just mentioned. He had them come to New York to participate in the conferences and the preparation of his plans; [50] he used them thereafter to help get his plan accepted.[51] The new management used the director last mentioned above as consultant when urging the plan before this subcommittee; [52] and presented him as an expert to defend the plan when it was under attack in a Baltimore court.[53] Thus Mr. Young failed in his avowed desire, "to avoid any implication that this plan was being written by the old group." [54]

[42] Exhibit No. 1341, Hearings, Part X, p. 4582 at pp. 4583-4584.

[43] Idem.

[44] Moody's *Steam Railroads* (1937), p. 1802.

[45] Now Jones, Day, Cockley & Reavis.

[46] He was also director of The Higbee Co., a Van Sweringen department store (Exhibit No. 1941, Hearings, Part X, p. 4582).

[47] Exhibit No. 1341, Hearings, Part X, p. 4582.

[48] Idem.

[49] Hearings, Part XIV, p. 6063.

[50] *New York Times*, May 6, 1937, p. 37.

[51] Idem.; and ibid., July 9, 1937, p. 25.

[52] Hearings, Part X, p. 4120; ibid., p. 4145; ibid., p. 4177.

[53] Tri-Continental Corp. et al. *vs.* The Chesapeake Corporation and Alleghany Corporation. In the Circuit Court No. 2 of Baltimore City. Hearings of August 13 and 14, 1937.

[54] Hearings, Part X, p. 4091. Later, in a contest with financial interests seeking control of the Chesapeake & Ohio, some of the old Van Sweringen executives whom the reform group had continued in office took sides with Mr. Young's opponents, and were eliminated by him from office in Alleghany Corporation.

III. THE PLAN AND THE RIGHTS OF INVESTORS

PLAN DESIGNED TO MAKE POSSIBLE DIVIDENDS ON ALLEGHANY STOCKS

The new management of the holding company, in explaining its plan to Alleghany security holders, declared that its purpose was in part "to eliminate one of the foregoing holding companies and to simplify the capital structure * * *." [55] Another motive also animated the Young group: the desire to make possible the payment of dividends on the preferred and common stocks of Alleghany Corporation, of which they were the largest holders.[56]

The Young syndicate owned 45,195 shares of Alleghany series A preferred stock, on which no dividends had been paid since May 1, 1931.[57] Alleghany's charter provided that no dividends *could* be paid on these stocks if the collateral pledged to protect the holders of any of Alleghany's three bond issues fell below 150 percent of the amount of bonds outstanding.[58] The collateral pledged to protect the holders of Alleghany's lowest grade of bonds, the so-called 5's of 1950, had fallen below the 150-percent line in August 1931, less than a year and a half after the bonds were issued, and had remained below thereafter.[59] As of June 30, 1937, the collateral behind this issue totaled less than 60 percent of the amount of bonds outstanding.[60] Until this default was cured, no dividends could be paid on either the preferred or common stock.

The devices used in the plan of July 8, 1937, in an attempt to get additional collateral for the 5's of 1950 and thus to make possible dividends, are worthy of special attention. They affected the contractual rights and priorities of holders of the following securities:

More than 500,000 shares of common stock of The Chesapeake Corporation outstanding in the hands of the public. The balance of common stock of The Chesapeake Corporation, about 71 percent of the total, was owned by Alleghany Corporation.

Nearly $25,000,000, principal amount, of Alleghany Corporation 20-year collateral trust convertible 5-percent bonds, due 1950 (the so-called 5's of 1950).

About 120,000 shares, without par value, of Alleghany Corporation cumulative prior preferred convertible stock, entitled to dividends of $2.50 per share per year and to $50 per share upon liquidation.

Some 667,000 shares of Alleghany Corporation cumulative 5½ percent preferred stock, series A, with a par value of $100 per share.

4,440,647 shares of Alleghany Corporation common stock, without par value.[61]

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[55] Exhibit No. 1250-A, Hearings, Part X, p. 4493.

[56] The Young-Kolbe-Kirby syndicate controlled 43.5 percent of the common stock of Alleghany Corporation, a total of 1,933,809 shares (Exhibit No. 1265, Hearings, Part X, p. 4506), plus 6.8 percent of the Series A preferred, a total of 45,195 shares (Securities and Exchange Commission *Report on * * * Protective & Reorganization Committees* [May 10, 1938], Part VII, p. 377 and footnotes thereto.) The Securities and Exchange Commission allots their holdings as follows:

Robert R. Young, 502,229 shares common, or 13.3% of total; 15,393 shares preferred or 2.3% of total.

Frank F. Kolbe, 253,813 shares common or 5.7% of total; 6,854 shares preferred or 1% of total.

Allan P. Kirby, 1,087,768 shares common or 24.5% of total; 22,948 shares preferred or 3.4% of total (Idem.).

[57] For Young-Kirby-Kolbe holdings, see footnote 56 above. Alleghany's dividends record appears in Moody's *Steam Railroads* (1936), pp. 530-531.

[58] Exhibits Nos. 43, 45, and 47, Hearings, Part I, pp. 265, 296, and 327, at pp. 271, 301-302, and 330.

[59] Exhibit No. 53, Hearings, Part I, p. 365.

[60] As of May 1, 1937, the appraised value of collateral securing $24,387,000 of 5's of 1950 was $14,542,190.05 (Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4472.) See also ibid., at p. 4473. But see also below, p. 31.

[61] Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4457.

The effects of the plan for the reorganization of Alleghany Corporation and the elimination of The Chesapeake Corporation on each of these five classes of security holders will be considered in order.

EFFECT ON HOLDERS OF THE CHESAPEAKE CORPORATION STOCK

Compared with Alleghany Corporation, The Chesapeake Corporation was a miracle of corporate simplicity. It owned shares of common stock in the Chesapeake & Ohio Railway Co., having a market value on June 30, 1937, of more than $140,000,000, and it owned miscellaneous other investments with a market value of about $8,000,000.[62] Its whole income from 1933 on consisted of dividends on its Chesapeake & Ohio stock.[63] On the basis of these dividends received, it declared dividends on its own stock, 71 percent of which went to Alleghany Corporation and the remaining 29 percent to minority stockholders.

The plan of reorganization would eliminate The Chesapeake Corporation from the scene altogether. Hence it would deprive the minority stockholders of the specific rights to which their stock entitled them.

The minority stockholders had no voice in this transaction by which their rights were to be altered. Alleghany Corporation, as holder of 71 percent of the stock, could decide the issue, and did decide the issue, by its own vote.[64] Willy-nilly, the minority holders would be frozen out by the plan.

Instead of their old rights as stockholders in The Chesapeake Corporation, the minority stockholders were offered their choice between two other rights.

First, they were offered 1½ shares of Chesapeake & Ohio Railway Co. common stock for every share of The Chesapeake Corporation stock.[65] This was approximately a proportionate distribution of the assets of The Chesapeake Corporation.[66] If the minority stockholders elected to take this alternative, they would get approximately the same dividends each year from the Chesapeake & Ohio that they would have got from The Chesapeake Corporation. If they chose to sell on the stock market, they would get a little more for 1½ shares of C. & O. common than they would for one share of Chesapeake common, since the market, distrustful of holding companies, tended to value holding company stock at less than the value of the stock which underlay it.[67]

As an alternative to 1½ shares of C. & O. common, the management offered the old Chesapeake minority for every share of Chesapeake common one share of a brand new preferred stock, which was dubbed "5% Cumulative Convertible Prior Preferred." [68]

[62] The closing market bid for C. & O. common June 30, 1937 (the date taken by the Young group for their estimates) was $52 per share, or $141,379,420 for the 2,718,835 shares owned by The Chesapeake Corporation. As of June 30, 1937, the indicated market value of all investments of The Chesapeake Corporation was $148,735,053.24 (Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4467 esp. footnote 7 thereto.)

[63] See published income accounts of The Chesapeake Corporation. The income account for 1936 is published in Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4463, and shows "miscellaneous other income" of $123.91.

[64] "* * * The vote of 71 percent of the common stock of Chesapeake owned by Alleghany was sufficient standing alone to approve the plan on behalf of that corporation." (S. E. C. *Report*, p. 403.)

[65] Exhibit No. 1250-B, Hearings Part X, p. 4494.

[66] It was approximately $2.67 per share less than a proportionate distribution of assets (Hearings, Part X, p. 4130). The $2.67 was to be used to pay taxes (Exhibit No. 1281, Hearings, Part X, p. 4521 at p. 4529), and other dissolution expenses (**Hearings, Part X, pp. 4130-4131.**)

[67] On August 10, 1937, the New York Stock Exchange price for 1½ shares of C. & O. was $8.62 higher than for 1 share of The Chesapeake Corporation stock; and during the years 1935 and 1936 the spread was greater (Exhibit No. 1346-C, Hearings, Part X, p. 4635 at p. 4637).

[68] **Exhibit No. 1250-B, Hearings, Part X, p. 4494.**

If members of the Chesapeake minority took the C. & O. common, they knew exactly what they were getting. The C. & O. had a long and unbroken record of earnings and of dividends paid out of earnings.[69] Its stock would represent a direct share in the equity of a prosperous railroad.

If, on the other hand, they took the brand new preferred stock, their position would be very different. They would not receive dividends directly from the C. & O.; instead, those dividends would go into the treasury of what had been Alleghany Corporation. Thence $300,000 of each year's income would go to pay general corporate expenses and $2,670,200 would go to pay interest on Alleghany's first two bond issues.[70] If anything were left over, an additional undetermined sum, perhaps as high as $1,219,350, would go to pay interest on the third bond issue, the so-called 5's of 1950.[71] If and only if there were anything left, would the former Chesapeake minority stockholder get anything.

In time of prosperity, of course, Alleghany's income from the C. & O. would be sufficient to pay its bond interest, with enough left over to pay dividends on the new preferred offered to the old Chesapeake minority. But in that case, another disadvantage would appear; dividends on this new preferred were limited to $5 per share. If Alleghany's income were enough to pay $5 per share on this preferred stock and something over, the something over would go to the holders of another preferred stock and of the common stock. No matter how high C. & O. dividends went, those of the former Chesapeake minority who accepted the proposed new preferred stock could not receive more than $5 per share.

If the Chesapeake minority accepted 1½ shares of C. & O. common, they would get the full dividend declared each year. But if they accepted the new preferred, they would be caught between two millstones. In bad years they would receive nothing until expenses and bond interest had been paid, and in good years they would receive nothing after their $5 per share dividend had been paid.

Neither the management's letter to Chesapeake stockholders [72] nor the documents sent them to describe and explain the plan [73] disclosed to the Chesapeake minority the full facts about future dividends. The Securities and Exchange Commission (S. E. C.), which was granted power by section 14 (a) of the Securities Exchange Act of 1934 to give security holders whatever protection might be afforded by a full and complete disclosure of the facts, found it necessary to intervene and to exercise this power on behalf of the investors. In a later report to the Congress of the United States, the S. E. C. said:

* * * Adequate information was not given which would enable a holder of Chesapeake common to judge the relative merits of the alternative offers open to him. As a minimum, information should have been given permitting an analysis in terms of Chesapeake & Ohio earnings of the dividend opportunities to be realized from each of the two offers.[74]

[69] The C. & O. had paid dividends in every year from 1889 on with the exception of 1915 and 1921 (Moody's *Steam Railroads* (1937), p. 1826.) Net income available for dividends exceeded dividends declared in every year from 1921 through 1935, and fell short of covering the extraordinary $5.80 1936 dividend by only 1.42 percent (Exhibit No. 1328, Hearings, Part X, p. 4571)

[70] Exhibit No. 1268, Hearings, Part X, p. 4508.

[71] If all holders of 5's of 1950 kept their bonds, they would have to be paid 5 percent on $24,387,000 (Exhibit No. 1248, ibid., at p. 4470) or $1,219,350 per year (ibid., p. 4466) before the new preferred received anything. If some or all holders of the 5's of 1950 accepted the new preferred in exchange, it would participate sooner, but it would be spread out over a larger issue.

[72] Exhibit No. 1250-B, Hearings, Part X, pp. 4494-4495.

[73] Exhibits No. 1248 and 1249, ibid., pp. 4456-4493.

[74] S. E. C. *Report*, p. 403.

Had the Chesapeake minority been given the analysis which the S E. C. considered a "minimum," they would have learned this:

Comparison of dividends on 1½ shares of C. & O. common and 1 share of the new preferred [75]

[This chart assumes that all holders of Chesapeake Corporation common and Alleghany Corporation 5's of 1950 would accept the offer of new preferred stock, and that C. & O. stock will continue to be the only source of Alleghany's income.]

If the C. & O. common stock dividend per share was—	Holders of 1½ shares of C. & O. common would receive—	The new preferred offered to the old Chesapeake minority in lieu of 1½ shares of C. & O. common would earn—
$0.50	$0.75	0
$1.00	1.50	0
$1.10 (*a*)	1.65	0
$1.50	2.25	$1.40
$1.93 (*b*)	2.90	2.90
$2.00	3.00	3.15
$2.50	3.75	4.90
$2.53 (*c*)	3.80	5.00
$3.00	4.50	5.00
$3.33 (*d*)	5.00	5.00
$3.50	5.25	5.00
$4.00	6.00	5.00
$4.50	6.75	5.00
$5.00	7.50	5.00
$5.50	8.25	5.00
$5.80 (*e*)	8.70	5.00

(*a*) Until this point, the new preferred earns *nothing*.
(*b*) Until this point, the new preferred earns less than 1½ shares of C. & O. common receives.
(*c*) Until this point, the new preferred earns less than its coupon rate, $5 per share.
(*d*) After this point, the new preferred receives less than 1½ shares of C. & O. common receives.
(*e*) This amount, $5.80, was the C. & O.'s actual dividend in 1936, the year prior to the formulation of the plan by the new Alleghany management.

Assuming that all Chesapeake Corporation minority stockholders and all holders of Alleghany 5's of 1950 accepted the offer of new preferred, there would be outstanding at the outset 776,757½ shares of that stock. This stock would earn (*a*) nothing until C. & O. common dividends reached $1.10 per share; (*b*) less than holders of 1½ shares of C. & O. common would receive until C. & O. common dividends reached $1.93 per share; (*c*) less than its $5 coupon rate until C. & O. common dividends reached $2.53 per share. And it would receive (*d*) less than 1½ shares of C. & O. common would receive whenever C. & O. dividends exceeded $3.33 per share.

The new preferred would earn more than 1½ C. & O. common shares would receive only if C. & O. common dividends were between $1.93 per share and $3.33 per share. Even if C. & O. dividends fell within the area favorable to the new preferred stock, the management might withhold dividends on the latter; such dividends, though cumulative, were not mandatory.[76]

The situation with respect to assets was not dissimilar, as the following table indicates:

[75] Chart prepared by the subcommittee staff. The new preferred would earn nothing until C. & O. common paid enough to cover general expenses ($300,000 per year) and bond interest ($2,650,000 per year)—(Exhibit No. 168, Hearings, Part X, p. 4508), or $1.10 per share on the 2,718,835 shares (Exhibit No. 1248, ibid., p. 4456 at p. 4475) which the reorganized company would own. Thereafter, every 1-cent increase in C. & O. dividends would increase Alleghany's income by $27,188 or 3.5 cents per share on the 776,757½ shares (ibid., at p. 4474) which would be outstanding. For another chart on the same topic, see Exhibit No. 1274, ibid., p. 4512.

[76] Mr. Young denied that he would misuse his power to manipulate dividends. (See Hearings, Part X, p. 427, quoted above at p. 4.)

Comparison of 1½ shares of C. & O. common with 1 share of the new preferred [77]

[This chart assumes that all holders of Chesapeake common stock and Alleghany 5's of 1950 will accept Mr. Young's offer of new preferred stock, and that the market value of assets other than C. & O. common will remain constant]

If the stock market price of C. & O. common stock to—	The stock market price of 1½ shares of C. & O. common would be—	The asset value of the new preferred stock would be—
$9.75 (*a*)	$14.62	----------
$10.00	15.00	----------
$12.54 (*b*)	18.81	----------
$20.00	30.00	$26.11
$21.94 (*c*)	32.91	32.91
$30.00	45.00	61.12
$40.00	60.00	96.12
$41.11 (*d*)	61.66	100.00
$50.00	75.00	100.00
$60.00	90.00	100.00
$66.67 (*e*)	100.00	100.00
$70.00	105.00	100.00
$77.75 (*f*)	116.62	100.00
$80.00	120.00	100.00

(*a*) This was the actual depression low, reached July 6, 1932.
(*b*) Until this point, the new preferred would have no asset value whatever.
(*c*) Until this point, the asset value of the new preferred would be less than the market value of 1½ shares of C. & O. common.
(*d*) Until this point, the asset value of the new preferred would be less than its claim ($100 per share).
(*e*) After this point, the asset value of the new preferred would be less than the market value of 1½ shares of C. & O. common.
(*f*) This was the actual post-depression high, reached November 4, 1936.

There would be no assets available to meet the claims of the new preferred whenever C. & O. common fell below $12.54 per share. The assets underlying the new preferred would be less than the market value of 1½ shares of C. & O. common whenever the common fell below $21.94 per share. There would be insufficient assets to secure in full the $100-per-share claims of the new preferred whenever C. & O. common fell below $41.11. And the new preferred's claim to assets would be less than the market value of 1½ shares of C. & O. common whenever that common rose above $66.67 per share. In short, the Chesapeake minority would be better secured by taking 1½ shares of C. & O. common than by taking the new preferred, whether that common rose or fell. Only when C. & O. common stood between $21.94 and $66.67 per share would the market value of the assets underlying a share of the new preferred exceed the market value of 1½ shares of C. & O. common.

A further hazard endangered those who might accept the new preferred stock. The new company was still subject to the bond indentures providing that, whenever the market value of collateral behind the bond issues fell below 150 percent of the bonds outstanding, no dividends could be paid on any stocks.[78] In case of a market decline which would reduce the market value of the securities owned by Alleghany, the corporation might find itself once again barred from paying dividends, and those of the old Chesapeake minority

[77] Prepared by the subcommittee staff. As of June 30, 1937, with C. & O. common at 52, the reorganized company would have $107,280,699.07 available for new stocks (Exhibit No. 1277, ibid., p. 4513). For every $1.00 change in the price of C. & O. common, the market value of 2,718,835 shares of C. & O. common would change $2,718,835. Hence with C. & O. common at $12.54, there would be no assets left for the preferred stock of the reorganized company. For every $1.00 per share rise above that figure, the reorganized companies assets would increase $2,718,835, or $3.50 per share on 776,757½ shares. If other securities in the Alleghany portfolio fluctuated in unison with C. & O. common, the "pincher" effect would be accentuated, and the area in which the new preferred showed an advantage over C. & O. common would be narrowed still further. If some or all of the holders of Alleghany 5's of 1950 refused to exchange for the new preferred, higher prices for C. & O. would be needed to give the new preferred any asset value.

[78] See p. 19, *supra*, and footnote 58 thereto.

who had elected to take new preferred would find themselves bereft of income at a time of depression.

Members of the Chesapeake minority who took C. & O. common would, as has been noted, own a direct share of the equity of a prosperous railroad. Those who elected to take new preferred would have a claim to what was left over after the claims of holders of $53,404,000 of bonds due in 1944 and 1949 had been satisfied, and after the claims of holders of an undetermined amount—perhaps as much as $24,387,000—of the third bond series, the 5's of 1950 had also been satisfied.

Such would be the situation, immediately after the plan became effective, of those members of the Chesapeake minority who accepted the new preferred. Thereafter, things might grow progressively worse. For the reorganized company could—

> borrow or raise money without limit, and upon any terms, for any purpose * * *; issue, sell, and dispose of the corporation's bonds, debentures, notes, certificates of indebtedness * * * and other obligations * * *, and as security therefor * * * mortgage, pledge, or grant any charge or impose any lien upon, all or any part of the * * * property * * * of the corporation * * *.[79]

These borrowings could, and in all probability would, come prior to the claims of the new preferred. Those who advanced this new money would have a prior claim to the assets once owned by the Chesapeake minority, and their interest payments would come before the dividends on the new preferred. The $53,000,000 or more of debt and the $2,970,000 per year or more of fixed charges and expenses which would come prior to the claims of the new preferred when the plan was consummated might be doubled or quadrupled, at the Young syndicate's discretion. Those of the Chesapeake minority who elected to take the new preferred would have no redress.

With the new money so raised, the new company could—

> acquire by purchase, subscription, or otherwise * * * shares of stock, bonds, debentures, notes, scrip, securities, evidences of indebtedness, contracts, or obligations, of any corporations * * *.[80]

In short the management could speculate as it pleased.

Saddling speculative losses on its security holders would not have been a new adventure for Alleghany Corporation. In 1929 and 1930 Alleghany had taken $100,000,000 of money raised from investors and had sunk it in Missouri Pacific stocks and low-grade bonds.[81] Missouri Pacific stock for which Alleghany Corporation had paid $79,690,000 had a stock-market value on June 30, 1937 (the date chosen by the reform group for its examples), of a bare $4,242,000.[82] Nothing prevented Mr. Young and the holding-company executives with whom he surrounded himself from indulging in a similar market plunge in the future, with similarly disastrous results. In fact, those who accepted the new preferred stock would be in even greater jeopardy than those whose money had been sunk in Missouri Pacific, for, as has been noted,[83] the plan would remove the 60-percent margin limitation designed to protect the holders of preferred stock.

[78] Exhibit No. 1249, Hearings, Part X, p. 4476 at p. 4477.
[79] Idem.
[80] Report No. 25, Part 8, of this subcommittee, entitled, "Alleghany Corporation: Acquisition of Missouri Pacific Railroad Company—Devices Used To Secure Consent of Missouri Public Service Commission." See also Hearings, Part XI.
[81] Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4469, esp. footnote 9 thereto.
[82] See *supra*, pp. 12–14.

Mr. Young himself confessed that control with a negligible investment

> * * * places a premium on going into debt and playing on a thin equity * * *.[84]

If the controllers of Alleghany Corporation succumbed to the temptation to go into debt and gamble on a thin equity, they would themselves reap the benefits. Those of the Chesapeake minority who elected to take the new preferred, along with other security holders, would suffer the losses.

The relative merits of the two choices offered to the Chesapeake minority were exhaustively studied by J. M. B. Hoxsey, for many years executive assistant to the New York Stock Exchange committee on stock list, later a member of that committee, and well qualified as an expert in investment matters. Mr. Hoxsey pointed out in a memorandum[85] the advantages of one choice and the disadvantages of the other. Mr. Hoxsey can hardly be charged with overstatement when he declared:

> The offer of new Alleghany preferred to Chesapeake Corporation stockholders seems very disadvantageous when compared with the offer of Chesapeake & Ohio common.[86]

But, no matter how much better off the Chesapeake minority would be if it accepted C. & O. stock, Mr. Young and his associates did not want them to choose that alternative.[87] In fact, if the Chesapeake minority unanimously accepted C. & O. common instead of new preferred, they might block one of the holding-company management's major purposes in proposing the plan, and indeed block the plan itself.[88]

One of the basic purposes in dissolving Chesapeake Corporation was to get additional collateral with which to cure the default on Alleghany's 5's of 1950, and hence to make possible payment of dividends on Alleghany preferred and common stocks.[89] The management hoped to remove the collateral default in several ways. First, Alleghany Corporation would get, like other Chesapeake Corporation stockholders canny enough to demand it, 1½ shares of C. & O. common for every share of Chesapeake. The market value of 1½ shares of C. & O. common was higher than the market value of 1 share of Chesapeake Corporation common. The added market value which Alleghany would receive by exchanging Chesapeake stock for C. & O. stock, the reform group proposed to use to help cure the default on the 5's of 1950.[90]

But this step alone would not be sufficient;[91] other devices were necessary.

[84] Hearings, Part X, p. 4072.
[85] Exhibit No. 1279, ibid., pp. 4514–4518.
[86] Ibid., at p. 4516.
[87] Hearings, Part X, pp. 4136–4137.
[88] Ibid., p. 4138, "They [the Chesapeake minority] can defeat it by taking C. & O."
[89] Exhibit No. 1248, ibid., p. 4456 at p. 4457.
[90] The Young group's original proposal was to deposit under the mortgage indenture securing Alleghany 5's of 1944 and 1949 only as much C. & O. stock as was necessary to maintain the market value equivalent of Chesapeake stock withdrawn, and to deposit the balance of the C. & O. stock taken out of Chesapeake Corporation under the indenture protecting the 5's of 1950; but Guaranty Trust Co., as trustee under the indentures, demanded that a full 1½ shares of C. & O. be deposited for every share of Chesapeake withdrawn. Nevertheless, the added market value resulting from the substitution would permit the switching of *other* collateral from the 5's of 1944 and 1949 to the 5's of 1950, and this it was proposed to do if necessary to cure the collateral default of the 5's of 1950. (For discussion, see Hearings, Part X, pp. 4123–4129.)
[91] Exhibit No. 1252, ibid., p. 4501.

The offer of new preferred to the old Chesapeake minority was one additional device. For if a Chesapeake stockholder took the new preferred stock, the 1½ shares of C. & O. common which he would otherwise receive would go into the treasury of Alleghany Corporation, and be used to help cure the default of the 5's of 1950.[92]

The men who prepared the reorganization plan must have known that if the old Chesapeake minority adequately understood the merits of both alternatives open to them, they would choose C. & O. common, and hence perhaps block the plan. Accordingly, the management used its position of control to "sweeten" as much as possible the appearance of the alternative which it wanted the Chesapeake minority to elect, and to discourage them as much as possible from taking the choice which was in their own best interest.[93]

PERSUADING THE CHESAPEAKE MINORITY TO ACCEPT THE PROPOSED NEW PREFERRED STOCK

The holding company officials wanted the Chesapeake minority to accept the new preferred stock, but could not force them to, lest the minority should appeal to the courts. Giving them the alternative of accepting C. & O. stock made the plan less vulnerable to court attack. In fact, when two large investment trusts owning Chesapeake common sued to stop the plan, the court ruled against them, in part on the ground that they were given the option of receiving C. & O. stock.[94]

Short of attempting to force the Chesapeake minority to take the new preferred, however, the holding-company management used many forms of blandishment to persuade them to act against their own best interests. These varied efforts can be considered in order.

1. *Renaming Alleghany Corporation.*—If the Chesapeake minority had been asked to exchange their stock in The Chesapeake Corporation for stock in Alleghany Corporation, they might well have refused. Alleghany Corporation was widely and unfavorably known in financial and market circles. Its past misdeeds and current misfortunes had received widespread publicity.[95]

Under the plan, the Chesapeake minority was not asked in so many words to accept Alleghany stock. They were asked to trade their stock in "*The* Chesapeake Corporation" for stock in "Chesapeake Corporation." They were nowhere explicitly informed that "Chesapeake Corporation" was in fact a new name for the reorganized Alleghany Corporation.[96]

2. *Naming the new stock.*—The management called the new stock which it offered the Chesapeake minority "cumulative convertible prior preferred." The C. & O. stock which they were entitled to select instead was called simply "common stock." [97]

[92] With C. & O. common at $55 per share, approximately 31 percent of the Chesapeake minority would have to accept the new preferred in order to cure the default on all the 5's of 1950. But this percentage would be reduced if some holders of the 5's of 1950 also accepted the new preferred. For example, with C. & O. common at $55 per share, if 40 percent of the 5's of 1950 were traded for the new preferred, the default would be cured even if all members of the Chesapeake minority refused to accept the new preferred. (Exhibit No. 1252, Hearings, Part X, p. 4501.)

[93] "What would you do in the same circumstances?" Mr. Young asked. (Hearings, Part X, p. 4136.)

[94] Exhibit No. 1542, Ibid., pp. 4584–4592. The court did, however, issue an injunction on behalf of the Alleghany Series A Stockholders (Idem.).

[95] See Mr. Young's statement to the press that "Chesapeake" was a better name than Alleghany (*Wall Street Journal*, May 27, 1937, pp. 1 & 4.) See also above, p. 8.

[96] Exhibit No. 1250-B, pp. 4494–4495. See also above, p. 7.

[97] Idem.

Through long-established usage, a "preferred" stock is considered as senior to a common stock, as safer, and as more conservative. A "prior preferred" is senior in claims to assets and to income over other preferred stocks. A "cumulative prior preferred" is further safeguarded. Making such a stock "convertible" gives it in addition the advantage of being able to share in the speculative profits of the common stock if those profits seem large enough and stable enough to warrant conversion.

In the case of a holding company, however, the situation is very different. A "cumulative convertible prior preferred" which rests merely on the common stock of another company is *junior* to the common stock of that other company. A stockholder, acquainted with the long-established terminology of the market place but unaccustomed to the dangers of holding-company operations might well believe that the proposed new "cumulative convertible prior preferred" stock was senior to and safer than the mere "common" stock of the C. & O. If so, he would be misled.

Alleghany officials did not invent the holding-company device by which stocks junior to the common stock of one company could be named "cumulative convertible prior preferred" stock of another company. But their plan did propose to perpetuate that device. It would mislead any unwary investor who relied on the plain words in the stock's name. Neither the plan nor the management's explanations clearly explained the real relationship between "The Chesapeake Corporation common" which Chesapeake stockholders were to be forced to relinquish and "Chesapeake Corporation cumulative convertible prior preferred" offered to them in exchange.

3. *Relying on Inertia.*—The management's plan made it perfectly easy for members of the Chesapeake minority to accept the alternative which the management wanted them to accept. *They had only to do nothing.* The plan proposed to accept silence and inaction as conclusive proof that stockholders wanted to accept the new preferred.[98]

On the other hand, if stockholders insisted on having the C. & O. common to which they were entitled, they had to act and act promptly. The management's letter to stockholders stated:

> To receive the foregoing 1½ shares of common stock of the Chesapeake and Ohio Railway Company, you are required to exercise your election so to do on or before August 16, 1937, by presenting your stock certificates at the office of Manufacturers Trust Company, 55 Broad Street, New York, N. Y., the agent of your company, for stamping thereon of a notation of your exercise of said option, whereupon said certificates will forthwith be returned to you. For your convenience, a form of letter of transmittal is enclosed.[99]

The management, as the record shows, proposed to adhere to the August 16 dead line. It notified the Manufacturers Trust Co. to stamp only such shares as arrived before 2 p. m. eastern standard time on that date.[1] If shares reached the company after 2 p. m. on August 16, they were to be returned to the owners unstamped; and willy-nilly the latecomers could be obliged to take the new preferred instead of the C. & O. common to which they were entitled.

[98] Exhibit No. 1250-B, Hearings, Part X, p. 4494.

[99] Idem. The letter of transmittal enclosed "for your convenience" required a Chesapeake minority stockholder to fill out a form, sign it, and get a bank or brokerage office to sign it also, to guarantee that his signature was genuine. He had to send the letter of transmittal, with the stock certificate itself, to New York.

[1] Exhibit No. 1352, Hearings, Part X, p. 4640 at p. 4641.

Mr. Hoxsey, the expert adviser to the New York Stock Exchange, told the exchange's committee on stock list what he thought of these tactics:

* * * No objection could be made if Chesapeake Corporation stockholders consciously made a selection of Alleghany preferred, but as it is it will probably be only through inadvertence or misunderstanding that any considerable part of the rights to take Alleghany preferred instead of Chesapeake and Ohio Common will be exercised.[2]

The plan was so drawn that full advantage would be taken of such "inadvertence or misunderstanding" to get additional collateral for during the default of the 5's of 1950, and hence to facilitate the payment of dividends on Alleghany's preferred and common stocks.

4. Taking advantage of the corporate gains law.—The dice were further loaded in favor of the acceptance of the new preferred as against C. & O. common by reason of a feature in the Federal capital gains tax law. The plan, as it was worked out, did not subject Chesapeake minority stockholders to any added tax if they accepted the new preferred stock, as the management wanted them to do. If, on the other hand, they exercised their own judgment and decided to demand their 1½ shares of C. & O. common, minority stockholders were informed that they would incur a tax liability.[3]

The matter was discussed at hearings before this subcommittee.

Mr. KAPLAN. That would operate as an effective club to compel the minority Chesapeake stockholders to come into the plan?

Mr. YOUNG. I should say that that is a club that I will not wield. It is a club in the situation by virtue of the Government's tax policies.[4]

The club was not, however, "in the situation by virtue of the Government's tax policies," but by reason of the management's plan. If it had left The Chesapeake Corporation undisturbed, the Chesapeake minority would not have had to pay any special capital-gains tax. If it had merged The Chesapeake Corporation into the Chesapeake & Ohio Railway Co. (as it was urged to do),[5] the stockholders would not have had to pay a special tax.[6] The tax liability arose as a direct result of the form in which the reorganization plan was cast.

Alleghany's management was not forcing the Chesapeake minority to accept the new preferred, but it was forcing them, without giving them any voice in the matter, into a dilemma. They had either to accept the new preferred, or to incur in many cases a substantial tax liability.

In the management's letter to Chesapeake stockholders, much was made of this dilemma. The minority was told:

In the opinion of counsel, stockholders who receive the new 5% cumulative convertible prior preferred stock of the consolidated company in exchange for common stock of the Chesapeake Corporation will derive no taxable gain or sustain no deductible loss for Federal income tax purposes. However, counsel are of the opinion that gain or loss may be recognized in the case of stockholders who elect to receive common stock of the Chesapeake and Ohio Railway Company.[7]

5. Personal Persuasion.—The renaming of Alleghany Corporation, the christening of the new holding-company stock "cumulative convertible prior preferred," the device for taking advantage of inertia,

[2] Exhibit No. 1279, ibid., p. 4514 at p. 4517.
[3] Exhibit No. ibid., p. 4494 at p. 4495; see also Exhibit No. 1273, ibid., p. 4511.
[4] Hearings, Part X, p. 4196.
[5] By Frederick L. Moore, of Kidder, Peabody & Co. (Exhibit No. 1315, ibid., p. 4559.)
[6] Idem.
[7] Exhibit No. 1250–B, ibid., p. 4494 at p. 4495.

inadvertence, and misunderstanding, and the use made of the capital-gains tax peculiarity—none of these factors succeeded in dissuading the bulk of the Chesapeake minority from demanding their 1½ shares of C. & O. stock.[8] But the holding-company's management did not rest there.

Shareholders who failed to act before 2 p. m. on August 16 were irrevocably bound to accept the new preferred; but those who elected to take C. & O. common were given every opportunity to change their minds.[9] Indeed, an office was established in New York as a center of distribution for propaganda in favor of the plan.[10] The expenses of this office were borne, not by the Young syndicate, but by The Chesapeake Corporation and Alleghany Corporation.[11]

The office was under the direction of Mr. R. J. Morfa,[12] who was not unacquainted with the work of persuading stockholders to do what holding-company chieftains wanted them to do. As far back as 1934, when Alleghany was unable to pay its interest and had to be reorganized, Mr. Morfa had been active in persuading Alleghany's security holders to accept a sacrifice of some of the rights to which their securities entitled them.[13] This subcommittee investigated the high-pressure methods used by Mr. Morfa during the 1934 reorganization.[14] The chairman commented on the fact that the reform management of the holding company was using for this work the same man employed by the Van Sweringens:

The CHAIRMAN. It shows continuity of method and the kind of tactics that were being used by Alleghany and the Van Sweringen group. It is in line, let me say, with the tactics that have been used throughout, the cheap, crooked tactics that have been used by the whole Alleghany crowd from start to finish, it seems to me. It is about time, Mr. Young, it seems to me, that that was stopped, if you expect to have anybody have any confidence in your group.

Mr. YOUNG. We certainly shall look into the situation, and if there is anything in Mr. Morfa's record that is bad, we will see that he is replaced.

The CHAIRMAN. We have just had one sharp practice after another all the way along the line. That has been disclosed in the whole Alleghany system from beginning to end.[15]

Alleghany's machinery of persuasion had been largely successful in the 1934 reorganization, and it made some progress even in persuading Chesapeake minority stockholders to accept the new preferred. By September 23, 1937, just 1 month after the dead line, owners of 8,431 shares of Chesapeake who had already demanded their C. & O. stock changed their minds and agreed to accept the new preferred.[16]

EFFECT ON HOLDERS OF ALLEGHANY 5's OF 1950

Of Alleghany Corporation's three bond issues, two were to remain undisturbed by the plan, except for the substitution of C. & O. common for The Chesapeake Corporation common in the collateral pledged to protect them.[17] Holders of the third Alleghany bond issue—the 5's of 1950—were offered a choice. They could, if they

[8] Of 521,745 shares of Chesapeake stock held by the Chesapeake minority, 324,387, or about 60 percent demanded exchange for C. & O. common as of August 16, 1937. (Exhibit No. 1348, ibid., p. 4638.)
[9] Hearings, Part X, pp. 4079–4084.
[10] Idem.
[11] Idem.
[12] Idem.
[13] Idem.
[14] Hearings, Part X, pp. 4079–4084, 4097, and 4287; and exhibits thereto.
[15] Ibid., p. 4082.
[16] Exhibit No. 1348, ibid., p. 4638.
[17] And the witbdrawal of certain excess collateral. (Hearings, Part X, pp. 4123–4125.)

wished, keep their old bonds, or they could exchange their old $1,000 bonds for $200 in cash and $800 in the same new preferred which the management was offering to the Chesapeake minority.[18]

Holders of the 5's of 1950 were not unaccustomed to having their rights in Alleghany Corporation shifted about. In 1934 they had submitted to an arrangement whereby their claims to interest in cash for the years 1934–39 were funded by an issue of Alleghany prior preferred.[19]

The success of the plan rested in considerable part on persuading holders of the 5's of 1950 to make an exchange.[20] For, as has been noted,[21] these bonds were protected by a mortgage indenture providing that, whenever the collateral pledged as protection fell below 150 percent of the face amount of bonds outstanding, no dividends could be paid, and the 5's of 1950 were in collateral default under this provision. If a sufficient proportion [22] of the holders of the 5's of 1950 would give up their bonds, there would be enough collateral to cure the default on the remainder and hence the way would be clear for paying interest on the preferred stock.

The management's proposal contained several features designed to persuade holders of the 5's of 1950 to make a trade.[23] First, they were offered $200 per $1,000 bond in cash. In the week ending June 30, 1937 (the date chosen by the holding company for its examples), the 5's of 1950 were selling at a discount of 18 percent.[24] The company's offer afforded holders of the 5's of 1950 an opportunity to liquidate one-fifth of their holdings without suffering the 18 percent loss which would have been theirs had they liquidated on the open market.

Again, at the time of the reorganization of Alleghany in 1934, holders of 5's of 1950 gave up their rights to cash interest payments until October 1939. The new management assured them that if they accepted the new preferred, they would receive dividends in cash immediately. The provision for immediate dividend payments was in fact a provision for double interest on the same investment.[25] Interest on the 5's of 1950 had already been settled in full to October 1939; the company now proposed to pay additional dividends for the same period.[26]

But there were also disadvantages to the exchange. Holders of the 5's of 1950 were nowhere explicitly informed, for example, that whereas interest on their bonds would be fully covered whenever C. & O. dividends totaled $2.02,[27] dividends on the new preferred would not be fully covered unless C. & O. dividends exceeded $2.52.[28] Again, holders of the 5's of 1950 had a lien on the collateral pledged under their bond indenture; those who accepted the new preferred and cash would sacrifice that lien.[29]

[18] Exhibit No. 1250–A, ibid., pp. 4493–4494.
[19] Hearings, Part X, p. 4076.
[20] Exhibit No. 1252, ibid., p. 4501.
[21] See above, p. 19, and footnote 58 thereto. The first two mortgage indentures there cited would remain undisturbed, and the third would remain in effect unless 100 percent of holders of the 5's of 1950 accepted the new preferred.
[22] For chart showing what proportion, see Exhibit No. 1252, ibid., p. 4501.
[23] The offer is summarized in Exhibit No. 1250–A, ibid., pp. 4493–4494.
[24] *Commercial & Financial Chronicle*, Vol. 145, p. 73. See also Hearings, Part X, p. 4126
[25] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4517. See also p. 4126.
[26] Idem.
[27] Exhibit No. 1267, ibid., p. 4507, also p. 4129.
[28] Exhibit No. 1268, ibid., p. 4508.
[29] Hearings, Part X, p. 4126.

Alleghany officials informed bondholders that the market value as of July 6, 1937, of the collateral pledged to protect the 5's of 1950 amounted to only 54 percent of the face amount of the bonds outstanding.[30] This was true; but bondholders were not informed of the further fact that excess collateral under the other indentures was available to secure their bonds to the extent of 98 percent of the face amount of bonds outstanding.[31] Nor did the new management make any attempt to live up to the terms of the indenture by which Alleghany pledged itself to maintain the collateral behind the 5's of 1950 at 150 percent. Mr. Young's excuse for not increasing the collateral protecting these bonds from 60 percent to 98 percent was that he could not in any case increase it to the 150 percent required by the indenture.[32] The reform group failure or refusal to collateralize as fully as possible the 5's of 1950 may well have helped persuade holders to make the exchange, since it led them to believe that they were giving up a lien on a smaller block of collateral.

EFFECT ON HOLDERS OF ALLEGHANY PRIOR PREFERRED STOCK

The Alleghany Corporation security ranking next after the 5's of 1950 was the so-called "cumulative prior preferred convertible" stock. Only 119,833 $50 shares of this stock were outstanding.[33] They had been issued in 1934, as noted above, in lieu of 5-year interest payments on the 5's of 1950. Holders of this "cumulative prior preferred convertible" stock were offered the new "cumulative convertible prior preferred." [34] There was little difference in name, but there was a difference in conversion rights.

The old prior preferred was convertible into common at the ratio of 1 for 10. The company's letter explaining the exchange told prior preferred stockholders that their new stock would also be convertible into common in the ratio of 1 to 10. But the letter did not explicitly point out that, in spite of the apparent similarity of conversion rights, those rights were actually being cut in half. For holders of the old preferred (which had a liquidation claim to $50 of assets) would be exchanging 2 shares for 1 share of the new preferred (having a liquidation claim of $100 of assets). Thus a holder of two shares of the old preferred would be entitled to convert into 20 shares of common, while after the exchange he could only convert into 10 shares of common.[35]

Mr. Young was of the opinion that in any case the conversion right was "of indeterminate value," [36] and hence a "minor point." [37] Whether major or minor, the management's letter to holders of this stock listed what was in fact a sacrifice as if it were an advantage. The letter stated:

> As the new 5% cumulative convertible prior preferred stock of the consolidated company will be convertible into new common stock of the consolidated company on the basis of 10 shares of such new common stock for each share held, you will

[30] As of July 6, 1937. As of May 1, 1937, the 5's of 1950 were secured to the extent of 60 percent. (Exhibit No. 1248, ibid., p. 4456 at p. 4473.)
[31] Excess collateral under the 5's of 1944 and 1949 amounted to about $8,500,000 (Hearings, Part X, p. 4127). This sum, added to the $14,543,000, already pledged, would secure the $24,387,000 of 5's of 1950 outstanding to the extent of 98 percent. (Exhibit No. 1248, Hearings, Part X, p. 4456 at p. 4472.)
[32] Hearings, Part X, pp. 4126–4128.
[33] Exhibit No. 1248, ibid., p. 4456 at p. 4457.
[34] Mr. Young's offer to holders of prior preferred convertible appears as Exhibit No. 1250–D, ibid., pp. 4497–4498.
[35] For discussion, see Hearings, Part X, pp. 4138–4139.
[36] Ibid., p. 4139.
[37] Idem.

be in a position to obtain the further benefits of the increased values which are believed possible under the consolidation.[39]

Discussion of "further benefits" and "increased values" resulting from the right to convert into *10* shares of common stock served to mask the *decreased* benefits resulting from sacrifice of the pre-existing right to convert into *20* shares of common stock.

EFFECT ON HOLDERS OF ALLEGHANY SERIES A PREFERRED STOCK

Like the holders of prior preferred, the holders of Alleghany series A preferred were offered no alternatives. They were offered in exchange for their old preferred stock shares of a new convertible preferred and warrants entitling them to purchase shares of new common stock.[39]

Alleghany series A preferred had been sold to the public in 1929, not as speculation but as an investment. The Van Sweringens and the bankers who sold it to the public had priced it at $100 per share, plus accrued dividends, indicating its "gilt-edged" quality.[40] The stock was protected by the 60-percent charter limitation described above,[41] so that supposedly the market value of the assets underlying this stock would always substantially exceed its claim to such assets.

The reorganization plan proposed to exact serious sacrifices from holders of this stock. As has been noted,[42] the plan wiped out the 60-percent margin limitation so that thereafter the corporation could issue in unlimited quantities bonds and other evidences of indebtedness ranking senior to this preferred.

In addition, the dividend rate on the securities of this class of stockholders was to be reduced by 9 percent. The old series A preferred carried a $5.50 dividend; the new convertible preferred carried only a $5 dividend—a sacrifice of claims totaling $333,000 per year.[43]

Again, the series A preferred was asked to sacrifice dividend arrearages totaling more than $22,000,000 or $33 per share. These dividend arrearages were due and owing to the holders of series A preferred. Prior to the proposed reorganization, Alleghany Corporation was required to pay the $22,000,000 in full before it could pay any current dividend on the preferred or any dividend whatever on the common. If the plan became effective, however, this requirement would be abolished. The $22,000,000 claim for back dividends would be wiped out, and the way opened for using money formerly owing to the series A preferred to pay dividends on the common.[44]

The $22,000,000 dividend arrearage could not, even if earnings were available, be cleared up until the default of the 5's of 1950 had been cured. The reorganization plan was designed to cure that default, but it proposed to deprive holders of the old preferred of the benefit of that cure. Prior to the effective date of the plan, they could not, by reason of the default, receive dividend arrearages. After the effective date, they could not receive dividend arrearages because of

[39] Exhibit No. 1250–D, ibid., p. 4497.
[39] The offer to holders of Alleghany Series A preferred appears as Exhibit No. 1250–C, ibid., pp. 4495–4496.
[40] Alleghany Series A preferred was offered at par ($100) plus accrued dividends in February and May, 1929, by a syndicate headed by Guaranty Co. of N. Y. (Exhibit No. 80, Hearings, Part I, p. 411 at pp. 413–415.)
[41] See above, pp. 12–14.
[42] Idem.
[43] Exhibit No. 1342, Hearings, Part X, p. 4584 at p. 4591. Fifty cents per share on the 667,539 shares outstanding (Exhibit No. 1248, ibid., p. 4456 at 4457) equals a sacrifice of $333,769.50 per year for the class.
[44] Hearings, Part X, pp. 4140–4141; also Exhibit No. 1342, ibid., p. 4584 at p. 4591.

the plan itself. Nor was this all. Just as the plan abolished the 60-percent margin limitation designed to protect the preferred stockholders from having their claims undercut or diluted, so it curtailed and vitiated the cumulative provision, designed to protect them from having money due them as dividends disbursed to the common-stock holders.

The old series A preferred had the right to receive dividends when earned, and to receive a valid claim to future earnings when dividends were not earned.[45] The new stock which the management offered them in exchange had no such provision. Dividends were to be cumulative only if earned. The company might fail to earn its preferred dividends for many years; if thereafter it did earn its preferred dividend and something more, the something more would not go to make up the deficit. It could go to the common-stock holders.[46]

Mr. Hoxsey, expert adviser to the New York Stock Exchange's committee on stock list, commented on the dangers of this provision:

> It would be, however, highly objectionable to list the stock of a holding company with any such provisions. This company is practically wholly dependent [for] its earnings upon dividends from C. & O. Its common stock will have an effective control of C. & O. and, within the limits of its available funds, can cause it to raise or lower dividends at will. It is conceivable, theoretically, that C. & O. might earn exactly enough to pay $5 dividend upon this stock every year but that it might be caused to pay dividends only every other year, in which case Alleghany common would receive the benefit of half the dividends paid. While nothing so raw as this is to be expected under any management, yet it is quite within the bounds of possibility that in course of time there might be a management that approximated this course. I know of no company that is comparable to this that has such a provision in its charter and it seems to me a dangerous precedent to list any of the securities of a financial company having such a provision. * * *[47]

As has been noted,[48] Mr. Young indignantly denied that the dividend policy of the Chesapeake & Ohio would be controlled for the benefit of the holding company. Yet this plan removed the one safeguard against an even greater evil—control of the Chesapeake & Ohio dividend policy for the benefit of the *common*-stock holders of the holding company, at the expense of both the C. & O. stockholders and the holding company preferred-stock holders.

Emasculation of the cumulative provision of this preferred stock insured that there need never again be an accumulation of arrearages. But it did not insure this desirable result by providing a capital structure which would make regular payments possible. Instead, it proposed to prevent future accumulations of unpaid dividends by providing that they need not be paid.

It was chiefly because of the emasculation of this provision for the protection of preferred-stock holders that Mr. Hoxsey considered that the stock which the reformers who took over control of the Alleghany system chose to call "convertible preferred" was misnamed and misbranded. "Every precedent for years of the Exchange", according to Mr. Hoxsey, "is against listing such a stock under any name higher than class A common"; and he added that in the case of holding companies it would be "highly objectionable" to list such a stock under any name whatever.[49] Mr. Hoxsey's assistant, Mr. Haskell, also

[45] For the full cumulative provision of the Series A preferred see Exhibit No. 83, Hearings, Part I, p. 387 at pp. 389–390.
[46] For the emasculated cumulative provision of the new preferred, see Exhibit No. 1249, Hearings, Part X, p. 4476 at pp. 4480–4481.
[47] Exhibit No. 1279, ibid., p. 4514 at p. 4518.
[48] See above, p. 4.
[49] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4518.

informed the committee on stock list that the stock "appears distinctly overnamed on the basis of its rights, preferences, privileges, etc." [50]

A further sacrifice was to be foisted upon holders of the series A preferred. Their original stock had a redemption price of $105 per share plus accumulated dividends, [51] or a total of $138 as of the time of the plan. Under the plan, their new stock would have a redemption price of only $100 per share plus accumulated dividends,[52] and, as has been noted, the provision governing future dividend accumulations was emasculated.

Again, holders of series A preferred had the right as a class to elect two directors in the event of certain specified defaults.[53] Instead of this right, the plan proposed to give them the right to vote share for share with other stockholders [54]—to cast 667,539 votes out of a total of 5,884,943.[55] Under the new set-up, the holders of the old series A preferred would not even be assured one representative on the board of directors; they would be effectively blanketed by the 4,440,647 votes allotted to the essentially valueless common stock.[56]

In return for their sixfold sacrifice, the holders of the series A preferred were to receive some alleged advantages. They would receive warrants entitling them to buy two shares of common stock at $5 per share at any time during the ensuing 6 years.[57] But the common stock would in the beginning have an asset value of *minus* $8.36 per share.[58] The chances of this deficit asset position being wiped out and a positive value of more than $5 per share being attained within 6 years were remote indeed; yet only under such conditions could the warrants offered the old series A preferred take on any real value. The warrants might well kick around the stock market during their 6-year life with a speculative value of a few cents or more, inducing purchases and sales, masquerading as a security or quasi security, offering a speculation in something which did not exist, and affecting the control of the vast Alleghany system. But, at least until C. & O. common reached $76.86 per share,[59] the stock which the warrants would entitle their holders to buy at $5 per share would never have a claim to assets worth $5 per share in the market.

The management's proposal also conferred on the new stock offered to holders of the series A preferred the supposed benefit of a right to convert each share into ten shares of the new common.[60] Since the series A preferred had a par value of $100 per share, this right was essentially a right to get common stock at $10 per share.[61] Mr. Young knew how slim was this supposed benefit thus conferred on the

[50] Exhibit No. 1280, ibid., p. 4519 at p. 4520.
[51] Exhibit No. 83, Hearings, Part I, p. 387 at p. 390. Unpaid dividend accumulations as of June 30, 1937, totalled $33.00 per share. (Exhibit No. 1249, Hearings, Part 10, p. 4476, at p. 4491.)
[52] Exhibit No. 1249, Hearings, Part X, p. 4476 at p. 4481.
[53] Exhibit No. 367, Hearings, Part I, p. 387 at p. 391.
[54] Exhibit No. 1249, Hearings, Part X, p. 4476 at p. 4482.
[55] Exhibit No. 1265, ibid., p. 4506.
[56] Idem.
[57] Exhibit No. 1250–C, ibid., p. 4495 at p. 4496.
[58] A $37,149,040.33 deficit on 4,440,647 shares (assuming 100% conversion of Chesapeake common into the new preferred). Exhibit No. 1277, Hearings, Part X, p. 4513.
[59] Assuming that other assets of the reorganized company remain stable and that the Chesapeake minority accepted the new prior preferred. The figure is reached as follows: The new common begins to acquire an equity when C. & O. common reaches $68.66 (Exhibit No. 1277, ibid., p. 4513). Thereafter, every $1.00 per share rise in C. & O. means a $2,718,855 rise in equity value of 4,440,647 shares, or $0.61 per share. (Idem.) Hence when C. & O. common rises $8.20 ($5.00 divided by $0.61) above $68.66, i. e., rises to $76.86, the new common will have an asset value of $5.00. If other Alleghany assets rose in value with C. & O. stock, the conversion point might be reached sooner, but if part of the Chesapeake minority refused to take the new preferred, the conversion point might be reached later.
[60] Exhibit No. 1250–C, Hearings, Part X, p. 4495 at p. 4496.
[61] Idem.

series A preferred-stock holders. He himself testified that "this [common] stock conceivably can hardly ever sell above 7½ [dollars per share]." [62]

A few real benefits, however, would accrue under the plan to the series A preferred. Curing the default of the 5's of 1950 would clear the way (for a time at least) for the payment of dividends if earned. Some of the debt formerly superior to it would be converted into stock (albeit a stock still senior to the holdings offered the series A preferred).[63] And Alleghany would have in its possession the additional assets resulting from exchange of Chesapeake minority stock for new Alleghany stock (although there was no assurance that these new assets might not again be pledged to some other class of investors). [64]

However, such benefits, even had they been multiplied manyfold, could not have made the plan equitable. For the benefits would come to the series A preferred by reason of sacrifices suffered by Alleghany bondholders and the Chesapeake minority. The sacrifices required of the series A preferred, however, would not flow back to these groups. They would flow on to the holders of common stock,[65] chief of whom were Mr. Young and his associates.

Mr. Young himself was more than willing to admit that the series A preferred was getting less than it was entitled to.

> The CHAIRMAN. These holders of $66,000,000 of preferred stock and $22,000,000 of back interest——
> Mr. YOUNG (interposing). *They are making a sacrifice.*[66]

Mr. Hoxsey, the stock exchange expert, went further. It was they, he said, who would "pay the bill." [67] He declared: "The security that bears all of the sacrifices is the series A cumulative preferred." [68] And he added: "If the future is reasonably prosperous, the [series A preferred] stockholders will * * * lose heavily." [69]

A Baltimore court similarly held that "the series A stock is asked to make sacrifices which are too severe for a court of equity to countenance in the case of a nonvoting stock * * *" [70] and that these severe sacrifices were a means of "affording the consolidated corporations's common a new and undeserved asset value." [71]

DEPRIVING THE SERIES A PREFERRED OF ITS VOTE

It was necessary, of course, for the holding company's officials to get approval of their plan from the common-stock holders, who would benefit. But they did not seek the approval of the series A preferred, who would in Mr. Young's own words, be "making a sacrifice." The management proposed to force this sacrifice upon them without giving them any right to vote.

Mr. Young testified that he would like to permit them to vote on the plan, but that he had neither the legal nor the moral right to

[62] Hearings, Part X, p. 4073.
[63] The new cumulative convertible prior preferred would be senior to the new convertible preferred; just as the old 5's of 1950 were senior to the old Series A preferred. (Exhibit No. 1248, ibid., p. 4456 at pp. 4470–4471 and p. 4474.)
[64] For discussion of this point, see above, p. 24.
[65] See below, pp. 38–40.
[66] Hearings, Part X, p. 4070. [Italics supplied.]
[67] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4517.
[68] Idem.
[69] Idem.
[70] Exhibit No. 1342, ibid., p. 4584 at p. 4591.
[71] Idem.

give them such an opportunity. Mr. Young's own attorney, however, declared that Mr. Young could have given them a voice in the matter.

Mr. KAPLAN. In the opinion of your counsel, the accumulation of dividends of $22,000,000 on the preferred stock can be wiped out in consolidation without a vote of the preferred stockholders?

Mr. YOUNG. That is correct.

Mr. KAPLAN. Whatever may be the balance of the plan, whatever way the advantage may weigh, the preferred stockholders, if the plan is consummated, will be compelled to wipe out this $22,000,000 without being given a vote?

Mr. YOUNG. Through no fault of our own. *We would much prefer that they have the right to vote.*

Mr. KAPLAN. You do not feel that you can give them the right to vote?

Mr. YOUNG. We can not. *We would like very much to give it to them;* but that was written into the contract back in 1929, and it cannot be changed. *We have not either the moral or the legal right to change it.*

Mr. KAPLAN. If counsel could devise a way whereby you could give the preferred stockholders a vote, you would gladly do so?

Mr. YOUNG. That is right. *I wish to give them a vote* in justice to the other people who hold contracts from this same company.

* * * * * * *

Mr. KAPLAN. Have you been so advised by counsel that you could not legally give the preferred stockholders the right to vote?

Mr. YOUNG. *We have never even discussed it,* because they felt and I felt, as a very substantial holder of this preferred stock, that the question was academic.

* * * * * * *

Mr. KAPLAN. You did testify that you would be delighted to give the preferred stockholder a vote if there were any legal method of doing so without impairing the rights of other security holders?

Mr. YOUNG. That is right.

The CHAIRMAN. You are disposing of about $88,000,000 worth of these rights that belong to them, without giving them a chance to vote, are you not? There is $22,000,000 of interest and $66,000,000 of principal.

Mr. YOUNG. That is right.

Mr. KAPLAN. Your counsel, Mr. [Glover] Johnson, [of the New York law firm, White & Case], is here, and I will ask him this question.

Is it your opinion, Mr. Johnson, that the preferred stockholders cannot be given the right to vote in this situation without impairing the rights of other security holders?

Mr. JOHNSON. We have not discussed nor considered it. I should judge it would be quite possible, by a stockholders' meeting amending the charter, to create a voting power.

Mr. KAPLAN. You do not think it would be possible without a charter amendment?

Mr. JOHNSON. *Yes. I think the roll could be called voluntarily.*[72]

Yet the holding-company management did not propose to call the roll voluntarily, to amend the charter, or to give the series A preferred a voice in any other way.

Indeed it was by deliberate choice of the reorganizers that the series A preferred were to be deprived of a vote. The operation which the plan proposed to perform was basically, as Mr. Young himself testified, a reorganization.[73] If it had been presented to security holders as a reorganization, however, the series A preferred would have been entitled to vote.[74] By presenting what was basically a reorganization as if it were a merger of Alleghany Corporation with The Chesapeake Corporation, the Young syndicate, in addition to reaping other advantages, effectively deprived the series A preferred of their right to vote. As Mr. Hoxsey, the New York Stock Exchange expert, put it:

[72] Hearings, Part X, pp. 4068–4069. [Italics supplied.]
[73] See above, p. 8, and footnote 59 thereto.
[74] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4516, also p. 4517.

The elimination of The Chesapeake Corporation * * * enables the management to deprive the 5½% series A present preferred stock of a vote, to which it would be entitled if this action were taken as a reclassification instead of as a merger * * *.[75]

The plan thus obviated the necessity of approval by the holders of $66,000,000 of series A preferred stock and $22,000,000 of claims for unpaid dividends. They were deprived of their right to vote by a group of reorganizers and advisers acting for Mr. Young, whose personal investment in the controlling block of Alleghany Corporation common stock totaled less than $255,000.[76]

SUBSTITUTE RIGHT TO AN APPRAISAL

By presenting what was basically a reorganization as if it were a merger, it was possible to deprive the series A preferred of a vote on his plan. But it was not possible to deprive them of the right to have their stock appraised under the jurisdiction of a court, and to receive in cash from Alleghany Corporation the price fixed in the appraisal, for this right was guaranteed them by the laws of Maryland,[77] under which the holding company was incorporated.

But while the managerial group could not deprive holders of series A preferred of their right to an appraisal, it could and did so arrange matters that a minimum number of them would exercise that right. Under the plan, if these stockholders did nothing, they would lose their right to an appraisal. Just as the Chesapeake minority had to take prompt and positive action in order to get its 1½ shares of C. & O. common, so the holders of Alleghany series A preferred had to take prompt and positive action in order to secure the right of an appraisal.

The literature sent to holders of this stock mentioned the right of appraisal, but mentioned it briefly, without explanation and without enumeration of the steps necessary to secure an appraisal. The company's letter said:

* * * Under the laws of the State of Maryland with respect to the consolidation of corporations, the vote of the holders of series A preferred stock of Alleghany Corporation is not required to consummate the consolidation, but holders of such stock, and of all other classes of stock of the constituent corporations, are entitled to register a protest at the meeting [of stockholders of the corporation to be held on August 17, 1937] to avail themselves of the appraisal statutes of the State of Maryland.[78]

This letter told each class A preferred-stock holder that he was *entitled* to register a protest. The letter did *not* give a stockholder the vital information that if he *failed* to register such a protest, he would lose his right to an appraisal and would be forced to accept the "sacrifice" which the reorganizers had designed for him.

Nor did the company's letter inform him of the other provisions of the Maryland appraisal statute; [79] for example, that even if he registered protest at the meeting, he would have to make "*a written demand* for the payment of his stock," and that he would have to make this written demand "within twenty days after the agreement of con-

[75] Ibid., at p. 4516.
[76] See above, pp. 1–2.
[77] Md. Ann. Code (Flack, *Supp.* 1935) Art. 23 (35, as reenacted by L. 1937, C. 504) 10.
[78] Exhibit No. 1250-C, Hearings, Part X, p. 4495 at p. 4496. Although the letter to holders of series A preferred explicitly stated that "all other classes of stock of the constituent corporations are entitled" to the same right, the letters to the other classes of stockholders failed even to mention this right. (Exhibit No. 1250-B and 1250-D, Ibid., pp. 4494–4495 and 4497–4498.)
[79] The Maryland appraisal statute (see note 77 above) is quoted in S. E. C. *Report*, p. 343.

solidation * * * has been received for record by the State Tax Commission (but not afterwards) * * *." The letter did not inform the stockholder that, if the corporation did not promptly make an offer for his stock which he considered fair, he would have to "apply by petition to any court of equity having jurisdiction over said corporation * * * for the appointment of three disinterested commissioners to appraise the fair value of his stock"; nor did the letter explain that unless he filed this petition with a court of equity "within thirty days after such written demand," he would again lose his right to an appraisal.

Suppose that a stockholder discovered in one way or another that, instead of merely being "entitled" to file a protest, he was *required* to file one, under penalty of losing his appraisal right altogether; suppose further that he discovered that he was required to make written demand for payment, and to make it within 20 days of the filing of the papers, and in addition to make written petition to a court of equity within 30 days thereafter; and suppose finally that he was able and willing to run the risk of an appraisal and to face the delay and cost incident to an appraisal. Even then the stockholder would not be permitted to keep what he had bought. He would get the "right" to be frozen out altogether.[80]

EFFECT ON HOLDERS OF ALLEGHANY COMMON

The chief investment of Mr. Young and his associates was not in Chesapeake stock or in Alleghany bonds or preferred stocks, but in Alleghany common.[81] This was the class which, under their plan, would reap most if not all of the benefits resulting from sacrifices by other classes of holders.

A Baltimore court, as has been noted, had pointed out the fact that Alleghany common had "no asset, only a strategic value." [82] No dividend had ever been paid on this stock. It had no claim to assets; indeed it had a *deficit* asset position of $18.55 per share, for securities senior to the common had claims amounting to $82,383,001.29 more than the market value of the assets available to satisfy such senior claims.[83]

Mr. Hoxsey, the expert of the New York Stock Exchange, took cognizance of the essential worthlessness of this stock. He said:

> * * * It would seem that any plan, to be really fair, must wipe out the present common entirely, giving to it merely rights to subscribe at a low price to a new issue * * *.[84]

To a casual observer, the rights and priorities of the common stock would seem to be affected hardly at all by the plan. On the surface, all that the plan proposed was a share-for-share exchange of old common for new common.[85] But, in fact, as a result of sacrifices

[80] The Chairman. * * * It is a freeze-out. * * * Here is a small stockholder who has a hundred shares of preferred stock. The effect of it is that he is frozen out or has to go along. You cannot put it on any other basis. He has a right to an appraisal, but the practical effect of it is that he has nothing. He goes along or is frozen out. (Hearings, Part X, p. 4070.)

[81] The syndicate controlled $427,000 of bonds out of $77,791,000; 4,358 shares of cumulative prior preferred out of 109,242; 14,400 shares of Series "A" preferred out of 667,539; but it controlled 1,933,809 shares of common out of 4,440,647. (Exhibit No. 1265, Hearings, Part X, p. 4506.) The S. E. C. *Report* shows Young-Kolbe Kib by holdings of Series "A" preferred as 45,195 shares out of 667,539. (S. E. C. *Report* p. 377, footnote 63 thereto.)

[82] Exhibit No. 1342, Hearings, Part X, p. 4584 at p. 4591.

[83] Exhibit No. 1276, ibid., p. 4512 at p. 4513.

[84] Exhibit No. 1279, ibid., p. 4514 at p. 4518.

[85] Exhibit No. 1250–E, p. 4498 at p. 4499.

imposed upon classes of investors senior to the common, this stock was to be favored with a whole series of benefits.

First, the *deficit* asset position of $18.55 per share prior to reorganization would be reduced to a *deficit* asset position of $8.36 per share.[86] To this extent at least, Alleghany common would, as a result of the plan, come nearer to taking on a real value.

Again, the opportunity for the common to benefit from an increase in the market value of C. & O. stock was greatly enhanced. Assuming that other assets remained constant, C. & O. stock would have to reach $83.30 per share before Alleghany common would have an asset value under the old set-up. If the plan became fully effective, C. & O. stock would have to reach only $68.66 per share to give asset value to Alleghany common.[87] The previous year C. & O. stock had sold for $77.75 per share; never higher.[88] As Mr. Hoxsey put the situation:

> * * * It may be many years, if ever, before Chesapeake & Ohio common reaches $83.30 but $68.56 * * * is within bounds of easy probability. * * *[89]

Thirdly, the common stock would be placed much closer to earnings as a result of the plan. Before reorganization, C. & O. dividends would have to exceed $4.01 per share before the common could participate.[90] Under the plan, the common would get all the remainder whenever C. & O. dividends exceeded $3.63 per share.[91] A $4 C. & O. dividend would earn nothing for the common under the old set-up; but would earn more than $1,000,000 for the common under the proposed new set-up.[92]

Fourthly, the common stock would benefit from the wiping out of the default on the 5's of 1950. So long as these bonds were in default, no dividends could be paid on any Alleghany stock.[93] By eliminating the default, the plan removed one barrier to the payment of dividends on the common stock.

Fifthly, the common would benefit from the conversion of bonds into preferred stock. Those who chose to convert would still have securities ranking senior to the common, but they would not have the right to throw the company into bankruptcy in case of default and hence deprive the common of control.

Sixthly, the common would benefit from the emasculation of the cumulative provision protecting the series A preferred. Under the old set-up no dividend could be paid on the common until dividends of previous years had been paid to the series A preferred.[94] Under the plan, the common stock could receive dividends in spite of the

[86] A deficit of $37,149,040.33 on 4,440,647 shares instead of a deficit of $82,383,001.29. (Cf. Exhibit No. 1276 ibid., p. 4512 at p. 4513 and Exhibit No. 1277, ibid., p. 4513.)

[87] Exhibit No. 1277, ibid., p. 4513.

[88] The all-time high of $77.75 was reached Nov. 4, 1936. (*Commercial & Financial Chronicle*, Vol. 143, p. 2956.) Prices higher than this prior to 1930 (e. g. $279.75 on Sept. 3, 1929) must be divided by 4 to compensate for the 4-for-1 division of shares in 1930. (*Commercial & Financial Chronicle*, Vol. 129, p. 1560.)

[89] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4517. Mr. Hoxsey calculated the price of C. & O. stock at which the new common would acquire asset value as $68.56. The subcommittee's calculation—$68.66—will be found in Exhibit No. 1277, ibid., p. 4513.

[90] Exhibit No. 1267, ibid., p. 4507.

[91] Exhibit No. 1268, ibid., p. 4508. To make this exhibit comparable with Exhibit No. 1267, as Mr. Young suggested (p. 4129), the $300,000 expense item in Exhibit No. 1268 has been omitted. If instead the $300,000 expense item were added to Exhibit No. 1267, the exhibits would show that prior to reorganization the common stock could not participate until C. & O. common paid $4.16 per share, whereas the new common could participate whenever C. & O. common paid $3.75 per share.

[92] Namely, 37 cents per share on 2,718,835 shares of C. & O., or $1,005,968.95.

[93] See above, p. 19.

[94] See above, p. 35.

fact that the preferred had been deprived of dividends for any number of years in the past.

Seventhly, and most strikingly, the common stock would benefit from the wiping out of $22,000,000 of claims for unpaid dividends by series A preferred stockholders. The series A preferred had a right to full payment of this $22,000,000 before a penny could be paid on the common.[95] The wiping out of this right meant that the first $22,000,000 of dividends paid to the common would be paid with money previously due the series A preferred.

Clearly Mr. Hoxsey was not far wrong when he stated:

* * * The plan thus appears to be, in its major aspects, a device to impart value to the common stock by taking it from senior securities. * * *[96]

SUPPOSED SACRIFICES OF COMMON STOCKHOLDERS

In testimony before this subcommittee, Mr. Young sought to justify the many benefits accruing to his common stock under the plan, on the grounds that common stockholders were also making sacrifices.

Mr. YOUNG. I should say that the common stock is giving up most of all. * * *[97]

These supposed sacrifices would be in the form of conversion rights and stock-purchase warrants granted to other classes of security holders. To the extent that these rights to convert other securities into common stock on a $10-per-share basis and rights to purchase common stock at $5 per share were exercised, the equity of the corporation would be divided among more shares, and hence the claims of the original shareholders would be to that extent diluted.

Mr. Young made much of the benefits of these conversion privileges and purchase warrants to other security holders and the burden they placed upon the common-stock holders. He talked at one time about "speculative possibilities through these conversion features which the common has given them to get them to come in;"[98] and he insisted that the Chesapeake minority would lose out only "to the extent that it is not offset by the conversion features which have been offered."[99] He declared:

* * * That is the point I have been trying to stress here—that through giving all these conversion privileges the common stock of Alleghany Corporation is very materially affected in its whole position.[1]

Mr. Young's repeated insistence that the conversion privileges and purchase warrants represented a sacrifice for the common stock and a benefit for other classes must, however, be read in the light of the following considerations.

1. Conversion on a $10-per-share basis would not affect the common stock until it reached approximately that price, if then. Mr. Young's stock, which prior to reorganization had a *deficit* asset position of $18.55 per share, could undergo a terrific appreciation before it reached a point where the conversion rights would be exercised. The common stock could increase in market price from $2.62½ [1a] to $10 per share before any "sacrifice" became effective.

[95] See above, p. 32.
[96] Exhibit No. 1279, Ibid., p. 4514 at p. 4518.
[97] Hearings, Part X, p. 4139.
[98] Ibid., p. 4134.
[99] Idem.
[1] Ibid., p. 4147.
[1a] The New York Stock Exchange high on June 30, 1937. (*Commercial & Financial Chronicle*, Vol. 145, p. 6[illegible])

2. Mr. Young himself testified that the new common "conceivably can hardly ever sell above 7½ [dollars per share.]"[2] He himself, when it served his purpose, belittled the value of the conversion rights. He described them as a "minor point,"[3] and said that they were "of indeterminate value."[4]

3. For the most part, the conversion rights were *not*, as Mr. Young testified, "features which the common has given them [other security holders] to get them to come in."[5] Rather, they were in part preexisting rights which the plan left unchanged or actually diminished. Holders of the 5's of 1950 had essentially the same conversion rights under the old set-up as they would have if they accepted the offer.[6] Holders of the old prior preferred would have their conversion rights *cut in half* by the reorganization plan.[7] The series A preferred and the Chesapeake minority would be given new conversion rights under the plan,[8] but the latter would bring in new assets in which the common would share.

In testimony before the subcommittee, Mr. Young insisted that "under the plan the common stock divides itself up not into 4,400,000 parts, but into another 20,000,000 parts."[9] His testimony neglected the plain fact that *even without the plan*, the common stock was subject to the possibility of wide conversion privileges.

So far as the warrants to purchase new common stock at $5 per share are concerned, similar considerations hold true. Until such time, if ever, as the common stock became worth more than $5 per share, Mr. Young and other common-stock holders would not be adversely affected by the warrants. If perchance Alleghany common should be worth enough to make the warrants valuable, the dilution of value would be in part at least offset by the new money brought in,[10] from which the original common stock would benefit substantially.

To sum up: Neither the conversion rights nor the purchase warrants would exact any real sacrifice from the common until long after it had begun to reap the benefits of the plan; they were of dubious value in any foreseeable future; and in any case they were in large part not new sacrifices by the common for other classes, but simply continuations or diminutions of rights already possessed by other classes.

[1] Hearings, Part X, p. 4073.
[2] Ibid., p. 4139.
[3] Idem. See above, p. 31.
[4] Ibid., p. 4134.
[5] The right to convert Alleghany 5's of 1950 into common stock in the ratio of $10 per share was granted as part of the 1933 reorganization.
[6] See above, p. 31.
[7] See above, pp. 27, 34.
[8] Hearings, Part X, p. 4140.
[9] Namely, $5.00 per share, which would be added to the stock's equity.

IV. MODES OF PRESENTATION OF THE PLAN

NONDISCLOSURE OF RELEVANT FACTS TO SECURITY HOLDERS

No such analysis of the 1937 plan for the reorganization of Alleghany as that contained in this report was sent to security holders. Instead they were sent (*a*) long and technical financial statements,[11] including balance sheets, descriptions of proposed new securities in legal terms, etc.; and (*b*) brief summaries [12] which failed to make full revelation of the relevant facts.[13] This matter was discussed at hearings before this subcommittee.

Mr. KAPLAN. To understand the situation fully a security holder would have to run through one pamphlet which is 29 pages long and another which is 37 pages long, that you have distributed?

Mr. YOUNG. They are that long because the S. E. C. requires it.

* * * * * * *

Mr. KAPLAN. Were you not advised that this consolidation is not subject to the provisions of the Securities and Exchange Commission Act?

Mr. YOUNG. Not if we want to comply with the regulations.

Mr. KAPLAN. And their regulations say that you have got to issue a 29-page pamphlet, for instance?

Mr. YOUNG. That is my understanding.

Mr. KAPLAN. Is that correct, Mr. Johnson?

Mr. JOHNSON [Grover Johnson, of White & Case, counsel to Mr. Young]. It is our opinion that the consolidation does not constitute, under the rules of the S. E. C., an offering or a sale which requires the filing of registration statements, with the Securities and Exchange Commission. However, under the broad aspects of full disclosure, everybody necessarily today is required to issue literature which is somewhat lengthy.

Mr. KAPLAN. They are not required by the statute. You do it because you want to do it, not because the S. E. C. requires you to do it. Is not that correct?

Mr. JOHNSON. Yes.

Mr. KAPLAN. The mere fact that you have sent out long, complicated documents does not mean that a security holder is going to understand your literature, does it?

Mr. YOUNG. No; I think if we condensed it he might not understand it. As a matter of fact, this situation is most complicated. I think that every security holder, where he does not understand a situation of this kind, should take competent advice.

* * * * * * *

Mr. KAPLAN. There are complicated financial schedules, balance sheets, income statements, closely printed footnotes?

Mr. YOUNG. Which I regret exceedingly.

Mr. KAPLAN. The ordinary security holder cannot be expected to understand his position from a reading of these documents, can he? It requires professional analysis, does it not?

Mr. YOUNG. That is why the Securities and Exchange Commission recommends that they be issued and that all material facts be disclosed, so that everyone can understand it.[14]

Senator Truman commented on the literature sent out to security holders.

[11] Exhibits No. 1248 and 1249, Hearings, Part X, pp. 4456–4493.
[12] Exhibits No. 1250–A through 1250–E, ibid., pp. 4493–4499.
[13] See above, p. 21; see also below p. 44.
[14] Hearings, Part X, pp. 4137–4138.

Senator TRUMAN (interposing). Mr. Young, I should like to say something to you about that very thing. You sent me copies of this proposed plan, the first and the second, I think. I read them very carefully. I confess that I am not a financier, nor a lawyer, but I do want to say to you that when I got through reading them—and I had them analyzed also—it was very difficult for me to find out exactly what was proposed to be done. In other words, had I been a minority stockholder I would not know what I was to get.[15]

Mr. Young, in testimony before the subcommittee, declared that he was eager to comply with the minimum requirements of the Securities and Exchange Commission. The literature sent to security holders, however, displayed no such eagerness. It was complex and involved, but it omitted simple facts which should have been included. In a report to the Congress of the United States, the Securities and Exchange Commission stated:

In the case of this plan of consolidation, an examination by this Commission of the management's solicitation literature disclosed a failure to set forth a number of material facts. Although the Commission possessed no jurisdiction to pass upon the fairness of the plan, it had the power under Section 14 (a) of the Securities Exchange Act of 1934 and the Commission's rules adopted pursuant thereto to assure security holders the protection afforded by a full and complete disclosure. It was necessary to exercise this power in the interests of investors.

The solicitation literature contained no information to indicate the extent to which the plan would benefit the Young-Kolbe-Kirby interests. It did not even disclose the holdings of this group in the securities of Alleghany Corporation. It was essential that the management's recommendations that security holders approve the plan, contained in the solicitation literature, should be read in the light of these disclosures.

It was also important that the stockholders be advised of the extent to which the management owned or controlled stock would be cast in favor of the plan. Such information would be material to security holders, who might be opposed to the plan, in determining whether it might be more feasible to fight the plan at the ballot boxes, than through other means. Information with respect to the Young-Kolbe-Kirby interests in the securities of the two companies was likewise essential to this end, as was the fact, also not set forth, that the vote of 71 percent of the common stock of Chesapeake owned by Alleghany was sufficient standing alone to approve the plan on behalf of that company.

Furthermore, adequate information was not given which would enable a holder of Chesapeake common to judge the relative merits of the alternate offers open to him. As a minimum, information should have been given permitting an analysis in terms of Chesapeake and Ohio earnings of the dividend opportunities to be realized from each of the two offers.

Patently, each Series "A" preferred stockholder should have been clearly informed that under the plan he would surrender his rights to accumulated dividends. Upon a careful analysis of the plan a stockholder could have ascertained that these arrearages would be lost. But in view of the importance of this right, and the extent of the sacrifice involved, a statement unequivocally setting forth this fact should have been included.

The literature also omitted to describe fully the statutory rights of the stockholders to appraisal and payment of their shares. There was a reference to these rights in the soliciting material sent the Series "A" preferred stockholders. The pamphlet to these stockholders dated July 8, 1937, stated:

"Under the laws of the State of Maryland with respect to the consolidation of corporations, the vote of the holders of Series 'A' Preferred Stock of Alleghany Corporation is not required to consummate the consolidation, but holders of such stock, and of all other classes of stock of the constituent corporations, are entitled to register a protest at the meeting to avail themselves of the appraisal statutes of the State of Maryland."

But there was no further statement of the steps these stockholders would have to take to perfect their rights. Furthermore, no reference at all was made to ap-

[15] Ibid., pp. 4143–4144.

praisal rights in the literature sent the holders of other classes of stocks. Yet such information was particularly important in view of the limited opportunity available to holders of the prior preferred stock and common stock to defeat the plan by voting against it. And the Chesapeake minority did not have even this limited opportunity, due to Alleghany's ownership of 71 per cent of the Chesapeake stock. Hence, the only protection possessed by minority holders of this stock who opposed the plan and therefore did not elect to take Chesapeake and Ohio Stock (except the possibility of resort to litigation) was that afforded by their statutory appraisal right. And as we have elsewhere pointed out, unless security holders are fully advised of these rights, it is likely that they will not learn of their existence, or, if they have this information, that they will not be fully advised of the conditions which have to be fulfilled to perfect their rights.

Upon ascertaining these facts, the [Securities and Exchange] Commission requested the companies to amplify the information which the companies had previously given to these security holders. Shortly thereafter an understanding was reached with representatives of the companies that the date set for the special meetings of the stockholders to approve the plan be adjourned until a later date in order to afford security holders ample time to reconsider the plan and their action thereon in the light of such additional information.[16]

CIRCULATION OF NONCOMPARABLE BALANCE SHEETS

In addition to the omissions noted by the Securities and Exchange Commission, two devices used in the literature supporting the plan are worthy of special consideration.

Included in the material sent to security holders were balance sheets of The Chesapeake Corporation and Alleghany Corporation as of June 30, 1937, and a sample or *pro forma* balance sheet of the proposed consolidated company as of the same date.[17] Viewing those balance sheets, an investor might be under the impression that his position would be substantially improved by the plan. A preferred stockholder would find, for example, that the asset value of his stock was being *quadrupled* by the plan.[18]

The plan, did not, of course, quadruple the asset value of his stock. Indeed, its asset value was *impaired* by the plan. As Mr. Young himself testified: "It is perfectly obvious * * * that you cannot have more left for the preferred than you had before; you are bound to have less." [19] A part of the seeming tremendous improvement resulted from the circulating of balance sheets which were not comparable.

Both the balance sheet of Alleghany before reorganization [20] and the balance sheet of the proposed new company [21] purported to be "as of June 30, 1937." In stating the market value of securities owned, the former balance sheet actually used market prices as of June 30, 1937. But in stating the market value of securities owned under the proposed new plan, Mr. Young and his associates took prices as of July 6, 1937.

[16] S. E. C. *Report*, pp. 402–404.
[17] Exhibit No. 1248, Hearings, Part X, p. 4456 at pp. 4467–4475.
[18] The balance sheets purported to show that prior to reorganization there would be assets available to the series A preferred totalling $7,000,000, and that after reorganization there would be assets available totalling $29,500,000. (Hearings, Part X, p. 4154; see also pp. 4151–4155.)
[19] Hearings, Part X, p. 4154.
[20] Exhibit No. 1248, Hearings, Part X, p. 4456 at pp. 4469–4473.
[21] Ibid., at pp. 4473–4475.

Between June 30 and July 6, the market price of securities in Alleghany's portfolio had increased by $8,748,932.92;[22] the result was a discrepancy of that amount between the two balance sheets.[23]

In defending the circulation of noncomparable balance sheets before this subcommittee, Mr. Young urged (*a*) that he was not personally responsible, (*b*) that there had "certainly been no intention here to deceive anyone;" and (*c*) that the $8,748,932.92 discrepancy was of minor importance.

MR KAPLAN. Why were two different dates taken?

MR YOUNG. I will have to let you ask that question of Mr. Johnson. [of White and Case, attorneys]

MR KAPLAN. Don't you consider yourself responsible for the literature that was distributed?

MR YOUNG. I certainly do not consider myself responsible for every word on these 29 pages. I left it to competent counsel—not only one set of counsel, but three sets of counsel. They worked day and night on these plans. They changed them continuously. All three said, "We have leaned over backward here to make the thing fair, and in our opinion it is the fairest prospectus that has ever been issued." And I accepted that.

MR KAPLAN. You signed this statement.

MR YOUNG. Yes, I did * * * I certainly wish that you would ask the three counsel concerned as to why that was done, and let them express their opinion, because, when you make statements of this kind, it reflects on three counsel and nine directors. There has certainly been no intention here to deceive anyone.

MR. KAPLAN. I am not imputing any intention. I am wondering whether that is the effect.

MR. YOUNG. I have told you it is not the effect in my mind, and I am sure that any fair-minded analyst who goes into the figures would be pleased to have the two sets of figures, showing how much they have changed in 6 days, due to fluctuations in market prices.

MR. KAPLAN. He does not have two sets of complete figures. He has one set of figures for the new company, and a different set of figures for the old company.

MR. YOUNG. Yes; and when he sits down to figure them out, the figures have changed again. I suppose we should send out a new statement each day, showing the figures as of that day. You are charging us with dereliction in not sending out a statement every day.

[22] Hearings, Part X, p. 4475.

[23] The amount of the discrepancy was as follows:

	Closing bid price on July 6, 1937 (Hearings, Part X, p. 4475)	Closing bid price on June 30, 1937 (Wall Street Journal)	Value as of July 6, 1937 (Hearings, Part X, p. 4475)	Value as of June 30, 1937	Extent of discrepancy between balance sheets
7,718,835 shares C. & O. common	$55.00	$52.00	$149,535,925.00	$141,379,420.00	$8,156,505.00
6,490.68 shares C. & O. preferred	93.25	93.00	5,640,755.91	5,625,633.24	15,122.67
9,000 shares Erie common	16.50	15.00	1,138,500.00	1,035,000.00	103,500.00
7,500 shares Pere Marquette common	25.00	26.75	687,500.00	735,625.00	* *48,125.00*
3,546 shares Lehigh C. & N	8.25	7.87½	276,754.50	264,174.75	12,579.75
22,900 shares Mo. P. common	3.62½	3.50	1,895,512.50	1,830,150.00	65,362.50
94,100 shares Mo. P. preferred	7.37½	6.12½	1,431,887.50	1,188,862.50	242,625.00
$11,152,000 Mo. P. convertible bonds	12.75	11.00	1,421,880.00	1,226,720.00	195,160.00
96,240 shares Pittston common	1.25	1.12½	620,300.00	614,097.00	6,203.00
4 shares Wheeling & Lake Erie prior lien	83.00	83.00	4,482.00	4,482.00	
Total					8,748,932.92

* Decrease.

MR. KAPLAN. All I am questioning is that you did not send out a comparable statement for the two companies, the old and the new. As a matter of fact——

MR. YOUNG. We cannot go on and send out an encyclopedia here. I think that you ought to talk this over with the men who are responsible for it. I cannot run seven or eight different railroads and be responsible for every nail that is driven and every tie that is replaced.

MR. KAPLAN. You do not think this [the $8,748,932.92 discrepancy] is a nail or a tie do you?

MR. YOUNG. I do. I think, insofar as the merits of this plan are concerned, it is less than a nail.[24]

TURNING A $41,000,000 DEFICIT INTO AN APPARENT $18,000,000 SURPLUS

Other reports of this subcommittee, issued or in preparation, deal with various accounting techniques common within holding-company organizations in the railroad field. These reports examine cases in which money spent and disbursed has been carried on railroad books as "special deposits";[25] cases in which items which were purely bookkeeping transactions involving no payments whatever, were carried on railroad or holding company books as "dividend income";[26] and one case in which an Alleghany-controlled railroad explained away a $50,000,000 discrepancy in sworn statements made to the Interstate Commerce Commission for 5 successive years on the ground that the $50,000,000 item was "inadvertently left out"[27] through a clerical error. Even this $50,000,000 "error" is dwarfed, however, by the device which the Alleghany reorganizers used in their literature sent to security holders, a device which turned a $41,000,000 deficit into an $18,000,000 surplus.

Examining the balance sheet of the proposed new company which Mr. Young sent him, any security holder would find that, after making full allowances for all liabilities, including capital stock, there remained the following item:

Capital surplus[28] ---------- $18,488,822.67

This was not an inference to be drawn from the balance sheet; it was a bald statement made in the balance sheet sent to all classes of security holders. Whence came this $18,000,000 surplus?

According to the balance sheet, there were to be outstanding upon the formation of the proposed new corporation 667,539 shares of the new convertible preferred stock.[29] This stock was entitled to $100 per share in liquidation;[30] carried a dividend of 5 percent on a $100 value;[31] and was to be issued in exchange, share for share, for the old $100 series A preferred,[32] for which shareholders had originally paid $100.[33]

But when the balance sheet was drawn up for submission to security holders, the stock was *not* entered as a liability at $100 per share.

[24] Hearings, Part X, p. 4155-4156.

[25] See Report No. 25, Part 3 of this series, entitled "Fallibility of Auditor's Certificates: Inadequacy of Price, Waterhouse & Co.'s Certificate to Missouri Pacific Stockholders." For a comparable instance of carrying money disbursed as "special deposits" by the C. & O., see Hearings, Part VII, pp. 2440 sqq., and a report of this subcommittee, in preparation, based thereon. See also "Wabash Railway Co.: Purchases of Lehigh Valley Stock," a report of this subcommittee, in preparation.

[26] See Report No. 25, Part 9, of the subcommittee, entitled, "Missouri Pacific System: Intercompany Dividends and Advances, 1926–1931," based on testimony and exhibits in Hearings, Part XII. See also Hearings, Part XXII, for similar accounting procedure by the Wabash Railway Co

[27] Hearings, Part VII, p. 2492.

[28] Exhibit No. 1248, Hearings, Part X, p. 4456, at p. 4477.

[29] Ibid., at p. 4474.

[30] Exhibit No. 1249, ibid., p. 4476, at p. 4481.

[31] Ibid., at p. 4480.

[32] Ibid., at p. 4485.

[33] Exhibit No. 85, Hearings, Part I, p. 411, at p. 419. The old stock was carried on the balance sheet at $100 per share. (Exhibit No. 1248, Hearings, Part X, p. 4456, at p. 4471.)

It was entered as "stated capital $10 a share." [34] As a result, the decimal point was moved one place to the left and what was in fact a liability of $66,753,900 appeared as a liability of only $6,675,390—an understatement of liabilities amounting to $60,078,510. The result was, by a stroke of the accountant's pen, to turn what was in fact a $41,589,687.33 deficit into an apparent $18,488,822.67 surplus.[34a]

ROLE OF INVESTMENT ADVISORY SERVICES IN SECURING ASSENTS TO PLAN

In testimony before this subcommittee, Mr. Young attempted to minimize the difficulty or impossibility which an ordinary security holder would face in trying to learn the truth from the literature sent him. Said Mr. Young: "He ought to rely more or less on his banker or broker, or on one of the three important statistical organizations [Moody's, Poor's, and Standard Statistics]." [35] He introduced into the record excerpts from analyses of the plan prepared by these three organizations.[36]

It is not surprising that Mr. Young believed that security holders should rely upon the three leading statistical organizations. For, almost without exception, they ignored facts then available and later presented before this subcommittee. They failed to ferret out or to supply the relevant facts which the Securities and Exchange Commission considered "a minimum." [37] They failed to inform security holders of many of the sacrifices which would be demanded of them under the plan, sacrifices which led the expert of the New York Stock Exchange to recommend that the new securities should not be listed,[38] and which caused a Baltimore court to enjoin the plan's sponsors.[39] They failed to call attention to the noncomparable balance sheets or to the $60,000,000 understatement of liabilities. They failed even to point out the steps necessary if holders of series A preferred wished to escape the plan and retain their rights of appraisal.[40] No security holder, reading the analyses prepared by "the three leading statistical organizations," would have been warned of the pitfalls lurking in the reorganization plan.

On the contrary, he would have found the plan praised. The following is a memorandum prepared by Mr. Young, and introduced at his request into the record of the subcommittee:

[34] Ib. I., at p. 4474.

[34a] Concerning write-downs for the purpose of decreasing apparent liabilities, Securities and Exchange Commissioner Robert E. Healy has said: "High up on the list [of abuses requiring correction] must appear an item dealing with that excrescence, that abomination which charter-mongering States—corporation 'Reno'—have put upon us in their 'liberalization' of corporation laws. I refer to that kind of preferred stock which, let us say, is issued for $50 a share, pays a dividend of $3 a share, has a call price of $52, is entitled upon liquidation to $50 in preference and has a par value of $40. The company issuing it brings us the balance sheet on which the preferred is carried at $40 per share and $10 a share is carried to a paid-in surplus account. We have seen many such. * * * The stock is a $50 share in every essential respect except the one which is of least importance, the par value. *Practices such as these menace the welfare of capitalism. Those responsible for them should take heed lest in winning too many such battles they lose the war.* * * * These are not mere academic bookkeepers' arguments. They go to the very vitals of investment appraisal and corporate responsibility. 'Accountancy,' a famous French financier is reported to have said, 'is government.' It is the heartbeat of modern corporate finance." (The Next Step in Accounting, by Robert E. Healy, in *The Accounting Review* for March 1938; quoted also in *The Accountants' Digest* for March 1939, at p. 94.) [Italics supplied.] Concerning no-par stock, Interstate Commerce Commissioner Joseph B. Eastman has said: "Stock without par value in my opinion is a step in the wrong direction and toward speculation, instability, and confusion of the public mind." (70 I. C. C. 208, at p. 210.)

[35] Hearings, Part X, p. 4144. Mr. Young identified the three statistical organizations by name at ibid., p. 4177.

[36] Exhibit No. 1282, ibid., pp. 4532–4533.

[37] See above, p. 21, also p. 44.

[38] Exhibit No. 1279, Hearings, Part X, p. 4514 at p. 4518.

[39] Exhibit No. 1342, ibid., p. 4584 at p. 4592.

[40] See above, pp. 37–38.

The leading statistical organizations, Moody's, Poor's, and Standard Statistics say the plan is:

1. Constructive.
2. Fair to all classes of security holders.
3. Feasible.
4. They recommend assent.
5. Excerpts from their services follow on the next page.

MOODY'S INVESTORS SERVICE

The terms proposed appear fair. It is, of course, probably too much to expect that individual security holders will not make objections and perhaps there will be more opposition than is now indicated. However, since the plan is a reasonable one, since it tends to accomplish what should be accomplished, and since its treatment of the various bond and stock holders appears to give adequate consideration to the differences of seniority, a cooperative attitude on the part of security holders rather than a hostile attitude is suggested.

STANDARD STATISTICS CO.

The plan for the consolidation of Alleghany Corp. and Chesapeake Corp. is considered constructive, in that it eliminates a holding company and places the Alleghany securities "closer to the rails". * * *

On this basis, the stamped 5s, 1950, at 70, still appear underpriced, and purchase is suggested. Both of the Alleghany preferred issues appear to be worth somewhat more than present prices of 41–44 on the basis of indicated earning power of the new preferreds, and should be held. The common will continue very much a marginal stock, with a ceiling at 5 by reason of the warrants accompanying the new $5 preferred.

Hoders of Chesapeake Corp. stock should accept the offer to exchange into C. & O. if they are speculatively inclined and their individual tax problems permit; if they desire a more conservative medium, exchange into the new 5% preferred would be desirable.

STANDARD STATISTICS RAILROAD SECURITIES

As a general policy, the Standard Statistics Company recommends acceptance of the exchange offer of new Chesapeake Corp. securities for securities of the present Alleghany Corp. and the Chesapeake Corp. The plan appears fair to all issues, and would accomplish the desired end of simplifying the holding company structure, as well as permitting immediate distribution of earnings.

The series A preferred, to receive one share of $5 preferred and warrants to buy two shares of common at 5, could receive at least partial dividends soon, it is believed, and would have substantial speculative possibilities.

POOR'S INVESTMENT SERVICE

Because of bond indenture restrictions, the Alleghany preferred issues are now far removed from dividends and the common has no equity in assets. The proposed plan is a practical solution of a complex financial problem and its support is counseled * * *.

Another step in the simplification of the complicated railroad set-up of the late Van Sweringens was proposed recently when a plan for merging Alleghany Corporation and Chesapeake Corporation was announced. The proposal is intended to eliminate Alleghany Corporation, which is in great disfavor because of its past financial practices, its tremendous capitalization, and its vulnerability under any railroad holding company legislation. The plan is necessitated, in the final analysis, by the tremendous losses incurred by Alleghany Corporation through its investments in the now bankrupt Missouri Pacific. The proposed plan would permit distributions to certain Alleghany Corporation security holders, at present barred from receiving income, although earnings are accruing to their stocks, because of restrictions in the bond indentures. All things considered, the plan appears fair to the various classes of security holders, and many factors indicate the decided possibility of a fairly speedy confirmation of the merger.[41]

This was the type of advice distributed to security holders by the statistical organizations upon whom Mr. Young thought reliance should be placed.

[41] Exhibit No. 1282, Hearings, Part X, pp. 4532–4533.

In view of the conflict between the views expressed by *Moody's, Poor's*, and *Standard Statistics*, and the points of view taken by such men or groups as the expert from the New York Stock Exchange, the Baltimore Court, and the Securities and Exchange Commission, Mr. Young was asked to testify concerning his relations with the statistical organizations.

Mr. LOWENTHAL. Mr. Chairman, might I ask at this point whether Mr. Young contacted the statistical organization before this plan went out?
Mr. YOUNG. We did; yes.
Mr. LOWENTHAL. Which statistical organization was that?
Mr. YOUNG. Standard Statistics and we contacted them with the idea of getting their help on the plan.[42]

It appeared that no payment had been made for the service rendered by Standard Statistics:

Mr LOWENTHAL (interposing). They rendered that service to you without any compensation?
Mr YOUNG. Yes.
Mr LOWENTHAL. Either direct or indirect?
Mr YOUNG. Yes.[43]

But Mr. Young had friends in the organization.

Mr YOUNG. I talked with all my friends who knew anything about securities, Senator. I turned to every place I could to get help and advice. I have friends in Standard Statistics whom I have known for years, and whom I regard most highly, and I think that they are probably better equipped than any other concern in the country to deal with a situation of this kind.[44]

Indeed, his assistant Mr. Robert M. McKinney, who was one of the three men constituting Young, Kolbe & Co.,

* * * used to be an employee of Standard Statistics * * *[45]

The chairman commented on the relations between Standard Statistics and Mr. Young:

The CHAIRMAN. I have always assumed that Standard Statistics was a high-class organization, but I am wondering whether or not Standard Statistics, and these other so-called statistical organizations which are supposed to advise their clients independently of any interest, or anything of the kind, are in the habit of sitting in and advising people and then advising their clients to buy that particular stock.
Mr. YOUNG. I do not know what their practice is in that regard. Mr. McKinney, who used to be an employee of Standard Statistics, says that they do that on many reorganizations.[46]

SUMMARY AND CONCLUSIONS

From time to time in recent years, executives of railroads, railroad holding companies, stock exchanges, trust companies, and other railroad and financial institutions subject to Federal regulation, have argued that legislation designed to eliminate corporate or financial abuses is unnecessary by reason of the fact that American industry and finance are able and willing to carry on their own reforms. According to this point of view, urged from time to time on this committee, on other committees concerned with regulatory legislation, and on regulatory commissions, the financial abuses uncovered by this and similar investigations are mere exceptions to the high standards which corporations and financial institutions set themselves. Groups holding this view do not condone abuses found among Van Sweringen companies, Insull companies, etc., but they state that these abuses are the result of the unusual character of the Van Sweringen, Insull, etc., managements.

[42] Hearings, Part X, p. 4144.
[43] Ibid., pp. 4144–4145.
[44] Ibid., p. 4159.
[45] Idem.
[46] Idem.

From time to time, also, individual reformers or reform groups arise, determined to wipe out the abuses instituted by previous managements and to set a higher tone in corporate affairs.

Such a reformer was Mr. Robert R. Young, who with a group of associates, procured control of Alleghany Corporation, the key holding company in the Van Sweringen empire, about May 1937.

In testimony before this subcommittee, Mr. Young insisted that he recognized the abuses which had occurred under Van Sweringen management, but believed that legislation to end these abuses was wholly unnecessary. "We are probably going to beat you to it," he informed this subcommittee.

Mr. Young's way of approaching the reformation of the Van Sweringen empire was by means of a reorganization plan, dated July 7, 1937, which would merge Alleghany Corportaion with The Chesapeake Corporation, and reorganize the merged company.

Mr. Young did not, of course, prepare the complex reorganization plan considered in this report by himself. He was aided by competent counsel—"not one set of counsel, but three sets of counsel. They worked night and day on these plans." Also, he or these counsel conferred with many of the outstanding financial, banking, and brokerage firms—for example, with J. P. Morgan & Co., Guaranty Trust Co., Morgan, Stanley & Co., E. B. Smith & Co., and "dozens" of others. Thus the plan issued by the Young group of reformers had the benefit of expert advice from many quarters. It may quite properly be taken as a fair example of "self-reform" in financial and corporate circles—the type which is believed by many to make regulatory legislation unnecessary.

This report indicates the extent to which "self-reform" failed in its task of reforming the Van Sweringen empire.

The new management claimed that its plan would eliminate Alleghany Corporation, the holding company in which the major abuses had occurred. Actually, instead of eliminating Alleghany Corporation, the reform plan merely changed the holding company's name.

They claimed that after the plan became effective, the resulting company would be a first-degree holding company. Actually, the resulting company would be in many respects a second- or third-degree holding company, and in some respects a fourth- and even a fifth-degree holding company.

Mr. Young had gained effective control of the $3,000,000,000 Alleghany corporate empire on a personal investment of $255,000. The reformers left shoestring control in the same hands.

The original Alleghany charter gave almost absolute power, hedged in by only a handful of limitations, to the corporation's controllers. The reformers, far from diminishing this power, actually proposed to remove one or more of the preexisting limitations.

Under the old management, railroads had been milked, books had been falsified, money from railroad treasuries had been wasted in stock market speculation, money had been syphoned from operating companies into holding companies, etc. The reformers proposed, at

the time of their reorganization plan, to leave day-to-day control of the Allegheny system in the hands of essentially the same men who had managed it during the period of these abuses.

The reorganization plan sponsored by the supposed reformers would have adversely affected the rights of many classes of security holders. Security holders were not informed in many cases of the extent of the sacrifices they were being asked to make. Adequate information was not given them. Confusing terminology was used. The plan was so set up that Federal tax laws were used as a club to obtain the acquiescence of security holders. Security holders who might desire to protest were in some cases not informed of the complex legal procedure necessary to make their protest effective. Security holders who failed to protest promptly or in due legal form were to be bound by the plan. At least one class of stockholders were deprived by the plan of their right to vote upon it. The ultimate beneficiary of most of the sacrifices demanded of various classes of security holders was the common stock owned in considerable part by the reform group.

In seeking to procure security-holders' consent to the plan noncomparable balance sheets were circulated. Two different dates were taken in valuing securities, as a result of which the reorganized company appeared to be more than $8,000,000 better off than it would have been had comparable balance sheets been used. By a bookkeeping method, a $66,000,000 liability was written down by 90 percent as a result of which a $41,500,000 deficit was made to look like a $13,500,000 surplus.

Other agencies of the corporate and financial community whose task it supposedly was to aid the security holders in assessing plans like that of the Alleghany reformers wholly failed to restrain or even to point out the misleading inaccuracies in the material distributed to security holders by the so-called reform group. Moody's Investors' Service, Standard Statistics, and Poor's Investment Service described the plan as "fair," "constructive," and "a practical solution." They suggested "a cooperative attitude," recommended "acceptance," and counselled "support." None of them denounced the noncomparable balance sheets, the $60,000,000 write-down of liabilities, the confusing terminology, etc., contained in material distributed to security holders by the "reformers."

The failure of "self-reform" by the corporate and financial community in this case can be attributed neither to ill will on the part of the leader of the reform group, nor to ineptness in the drafting of the reform plan, nor to lack of guidance from the most respectable sections of the financial community. It is thus clear that—even when the financial community is on its best behavior, eager to "beat" the Congress of the United States to the task of reforming prior abuses, and aware that it is operating in the bright light of critical scrutiny from many quarters—the nature of the financial system is such that under ideal circumstances self-reform in the holding company and other fields, without disinterested public regulation, may be impossible. It is too much to expect, as the Alleghany reform plan vividly illustrates, that a group in control of an enterprise shall commit financial suicide; and the abuses common to holding-company structures in railroad and similar spheres lie so deep that basic self-reform can rarely, if at all, be instituted by measures short of financial suicide.

This subcommittee concludes that the abuses which it has uncovered in this and in similar instances cannot be left exclusively to the process of self-purification by a financial reform group. Legislative and administrative intervention is necessary for the surgical removal of the abuses inherent in our holding-company structures.

PUBLISHED REPORTS

Subcommittee of the Committee on Interstate Commerce, United States Senate, pursuant to S. Res. 71 (74th Cong.), authorizing an investigation of interstate railroads and affiliates with respect to financing, reorganizations, mergers, and certain other matters.

Report No. 180 (75th Cong., 1st sess.):
"Midamerica Corporation: Extent and Adequacy of Interstate Commerce Commission Jurisdiction over Railroad Consolidation and Holding Company Control."

* * * * * * *

Report No. 25 (76th Cong. 1st sess.):
Part 1—"A Problem in Railroad Reorganization: Reorganization Plans as Causes of Recurrent Insolvencies."
Part 2—"A Problem in Railroad Reorganization: Role of Life Insurance Companies: Missouri Pacific System."
Part 3—"Fallibility of Auditors' Certificates: Inadequacy of Price, Waterhouse & Co.'s Certificate to Missouri Pacific Stockholders."
Part 4—"Control of the Chicago & Eastern Illinois Railway Company."
Part 5—"Chicago & Eastern Illinois Ry. Co.—Concealment of Loan Transaction with C. & O. Ry. Co."
Part 6—"Need for Amendment of Section 77 of the Bankruptcy Act: Illustrative Matter in Subcommittee's Hearings and Reports in Support of S. 1869 (76th Congress, 1st Session)."

* * * * * * *

Report No. 25 (76th Cong., 3d sess.):
Part 7—"Missouri Pacific System: Reorganization, Expansion, and Financing 1915–1930."
Part 8—"Alleghany Corporation: Acquisition of Missouri Pacific Railroad Company—Devices Used to Secure Consent of Missouri Public Service Commission."
Part 9—"Missouri Pacific System—Intercompany Dividends and Advances—1926–1931."
Part 10—"Missouri Pacific System—Acquisition of Fort Worth Belt Railway Company."
Part 11—"Market Operations with Railroad Funds—Missouri Pacific Purchases of System Securities and Related Accounting Practices."
Part 12—"Control of the Chicago Great Western: Bremo Corporation."
Part 13—"Chicago Great Western Dividends."
Part 14—"Chicago Great Western Purchases of its own Stock."
Part 15—"Chicago Great Western R. R. Co.: Kansas City Southern Stock Transaction."
Part 16—"Chesapeake & Ohio Railway Company: $15,000,000 Preference Stock Issue of 1937."
Part 17—"Delaware & Hudson System—Purchases of Lehigh Valley and Wabash Stocks."
Part 18—"Chicago, Milwaukee & St. Paul Railway Company: 1925–1928 Receivership and Reorganization."
Part 19—"1925–1928 Receivership and Reorganization of the Chicago, Milwaukee & St. Paul Railway Company—Role of the Guaranty Trust Company of New York."
Part 20—"Chicago, Milwaukee & St. Paul Railway Company: Fees and Expenses of 1925–1928 Reorganization."
Part 21—"Chicago, Milwaukee, St. Paul & Pacific Railroad Company: Control of the Reorganized Company."
Part 22—"Chicago, Milwaukee, St. Paul & Pacific R. R. Co., Some Aspects of Its Financial History, 1925–1935."
Part 23—"Wabash Railway Company: Income in 1930."

Part 24—"Pennroad Corporation: Formation and Initial Financing."
Part 25—"Alleghany System—Midamerica Corporation: Its Uses as a Holding Company."
Part 26—"Alleghany System—Sale by George A. Ball; Tax Avoidance Through Charitable Foundations."
Part 27—"Alleghany System—Acquisition of Control by Robert R. Young."

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Report No. 1182 (76th Cong., 3d sess.):
"Railroad Combination in the Eastern Region":
Part 1 (Before 1920).
Part 2 (1920–1924).
Part 3 (1924–1926).
Part 4 (1926–1929).
Part 5 (1930–1932).

○

Part 2

77TH CONGRESS } SENATE { REPORT No. 26
1st Session } { Part 2

INVESTIGATION OF RAILROADS, HOLDING COMPANIES, AND AFFILIATED COMPANIES

ADDITIONAL REPORT

OF THE

COMMITTEE ON INTERSTATE COMMERCE

PURSUANT TO

S. Res. 71

(74th Congress)

A RESOLUTION AUTHORIZING AN INVESTIGATION OF INTERSTATE RAILROADS AND AFFILIATES WITH RESPECT TO FINANCING, RE-ORGANIZATIONS, MERGERS, AND CERTAIN OTHER MATTERS

SOME EDUCATIONAL, LEGISLATIVE, AND SELF-REGULATORY ACTIVITIES OF UNITED STATES RAILROADS

OCTOBER 16, 1941,—Ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1941

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77TH CONGRESS
1st Session

SENATE

REPORT No. 26
Part 2

INVESTIGATION OF RAILROADS, HOLDING COMPANIES, AND AFFILIATED COMPANIES

OCTOBER 16, 1941,—Ordered to be printed

Mr. WHEELER and Mr. TRUMAN, from the Committee on Interstate Commerce, submitted the following

REPORT

[Pursuant to S. Res. 71 of the 74th Cong.]

SOME EDUCATIONAL, LEGISLATIVE, AND SELF-REGULATORY ACTIVITIES OF UNITED STATES RAILROADS

INTRODUCTION

Between 1920 and 1936 the railroads of the United States paid in excess of $182,000,000 [1] to over one hundred and thirty national, state, and regional organizations concerned with railroad matters.[2] These organizations ranging from the Association of American Railroads, composed of 99 percent of the Class I roads, down to small local associations, were formed for the purpose of dealing with the operating, management, traffic, legal, financial, and research problems peculiar to the railroad industry.[3]

In addition to membership in their own associations, the railroads have been active in many other bodies which are directly or indirectly concerned with transportation questions, such as shippers' and manufacturers' organizations,[4] security owners' associations,[5] safety councils,[6] taxpayers' groups,[7] chambers of commerce, and so forth.[8]

Through these varied channels the railroads of the country have not only dealt with specific problems of railroad operations but have

[1] Exhibits Nos. 3440–3443, Hearings, Part XXIII, pp. 10441–10449. Ibid., pp. 10068–10070.
[2] Ibid., pp. 10063–10064. The subcommittee was unable to obtain complete information on the number of railroad organizations and the amount of money spent on them. The total may therefore be much larger than these figures. See Hearings, Part XXIII, p. 10070.
[3] Ibid., pp. 10067, 10070; Exhibit No. 3437, ibid., pp. 10435–10436.
[4] Ibid., pp. 10147, 10134 et seq.
[5] Ibid., p. 10013 et seq.
[6] Exhibits Nos. 3566, 3545, ibid., pp. 10564, 10544.
[7] Ibid., p. 10171.
[8] Ibid., pp. 10159–10160.

carried on educational and legislative programs and have endeavored to institute a system of self-regulation within the railroad field.

This report deals with some aspects of the organization and activities of United States railroads both in their own associations and others. Testimony on the subject is recorded in the subcommittee's hearings, part XXIII.

THE FUEL-POWER-TRANSPORTATION EDUCATIONAL FOUNDATION

In the realm of education the railroads have been active for many years and have employed a variety of methods for disseminating information concerning the industry. Individual carriers and railroad associations have publicized their activities,[9] outside organizations interested in transportation have used their facilities for education on the subject,[10] and in some cases organizations have been created for the express purpose of carrying on educational work.

Railroads, of course, are entitled to the privilege of spreading knowledge about their activities. It is perfectly legitimate for any industry to endeavor to get its point of view before the people of the country. Criticism can only arise when material originating from the railroads is not so designated. Railroads being a public utility, the public has the right to know the source of any information concerning them in order to evaluate properly the extent to which such information may be biased.[11]

An example of the educational activities of railroads is found in the work of the Fuel-Power-Transportation Foundation, an organization brought into being by the carriers.

ORIGIN OF THE FOUNDATION

The formation of the Foundation in 1927 was suggested to certain railroad executives by an experiment in education carried out 4 years earlier.

In 1923 Mr. Samuel S. Wyer, a consulting engineer of independent means engaged in educational and research work,[12] was employed by the Smithsonian Institution to make a study of the State of Pennsylvania's resources.[13] One of the officers of the Pennsylvania Railroad upon hearing of the project "recommended that the P. R. R. interest itself in adding a Transportation Chapter to the Smithsonian booklet and distribute 25,000 copies of the enlarged brochure in the schools of Pennsylvania." [14] The Pennsylvania Railroad accepted the suggestion and endeavored to get other roads in the state to cooperate in financing the program.[15] Failing in this effort, the Pennsylvania nevertheless went ahead and itself underwrote the entire cost, which amounted to $9,000 for preparation of the transportation feature and $23,500 for printing 25,000 copies of the whole pamphlet.[16]

[1] See pp. 8–18, 22–40, 47–51, infra.
[2] See pp. 19, 42, 54, 57, infra.
[3] Hearings, Part XXIII, pp. 10075–10076.
[4] Ibid., pp. 10093–10094.
[5] Ibid., p. 10095.
[6] Exhibit No. 3464, ibid., p. 10472 at p. 10473.
[7] Ibid., p. 10095.
[8] Ibid., pp. 10095–10096. Subsequent efforts to collect resulted in securing $2,512 from the Lehigh Valley Railroad, and $500 from the Cheswick & Harmar Railroad (subsidiary of the Philadelphia Company, a utilities holding company). Exhibit No. 3464, Hearings, Part XXIII, p. 10472 at p. 10473.

However, the schools which received copies of the study were not aware of the fact that the whole cost of distributing them was paid by a railroad.

The CHAIRMAN. In that work that you did there they put up $37,500 for the purpose of distributing literature through the schools, and in it did you say it was being paid for by the Pennsylvania Railroad Co.?
Mr. WYER. No.[17]

Instead, the pamphlets were given to the schools as educational material put out by an independent organization.[18]

While Mr. Wyer denied that any of the matter contained in the brochure was "propaganda" for the railroads,[19] a letter from the files of the Pennsylvania Railroad indicates that by this indirect method it was possible to distribute information more widely than if it were given out as coming directly from the railroads.

Our experience in Pennsylvania, as you will recall, developed that the transportation story, coming from an *independent agency*, is not only more acceptable to the public but has a direct appeal to the various educational groups.[20]

In fact so great was the demand for this brochure that the railroads which had refused to help finance it, subsequently endorsed the idea of forming a permanent organization to continue such work.[21]

ORGANIZATION, PURPOSE, AND FINANCING OF THE FOUNDATION

It was Mr. J. J. Bernet, then president of the Erie Railroad and one of the directors of the Ohio State Chamber of Commerce, who suggested to that body "a nationwide educational campaign to acquaint the public through the schools and by other agencies with the fundamentals of the problems of fuel, power, and transportation." [22]

Pursuant to this resolution the Fuel-Power-Transportation Foundation was established at Columbus, Ohio, in 1927 with Mr. Wyer in charge.[23] The Foundation stated as its object the dissemination of educational material through public lectures and the distribution of free pamphlets to schools.[24] It represented itself as an "independent organization," interested in the "presentation of facts only, without conclusions or recommendations." [25]

To finance the transportation part of the program, the Ohio Chamber of Commerce asked the railroads to contribute $12,000 a year for three years through the Conference of Eastern Railroads.[26] But this body refused on the following grounds:

* * * Our study of this situation, however, indicates that the railroads make the greatest progress when they keep their public relations work absolutely within their own hands. Our work in schools and colleges has been steadily expanding during the past two years and our speaking engagements have brought us in close touch with many leaders in educational institutions. We find that the one thing they are inclined to fear is the introduction of propaganda.

[17] Ibid., p. 10096.
[18] Ibid., pp. 10096–10097.
[19] Ibid., p. 10096.
[20] Exhibit No. 3495, ibid., p. 10495. [Italics supplied.]
[21] Exhibit No. 3464, ibid., p. 10472 at p. 10473.
[22] Exhibit No. 3464–A, ibid., p. 10474; ibid., p. 10097.
[23] Idem.
[24] Exhibits Nos. 3470, 3485, ibid., pp. 10481–10482, 10489.
[25] Exhibits Nos. 3479, 3485, ibid., pp. 10486–10487; 10489.
[26] Exhibit No. 3492, ibid., p. 10493. Other phases of the program were supported by other contributions, including some from the public utilities power companies. Hearings, Part XXIII, p. 10113. See also the Summary Report of the Federal Trade Commission on "Efforts by Associations and Agencies of Electric and Gas Utilities to Influence Public Opinion," Senate Document 92, Parts 71A and 81A, 70th Congress, 1st session.

* * * There is no doubt that educators welcome the direct manner in which railroads are now presenting their information to schools and colleges but we do not believe that any campaign of education in the hands of outsiders will be similarly received. * * *[27]

This reasoning apparently did not appeal to all members of the conference. When the eastern railroads as a group did not make any contribution,[28] the Pennsylvania Railroad again took the initiative, canvassed the roads individually, and secured from eleven railroads the $36,000 necessary for three years' work.[29] The Pennsylvania Railroad, however, was sufficiently in accord with the arguments of the Conference on Eastern Railroads to believe that the railroads' contributions should be made public. On January 14, 1929, an executive of the road wrote to the Fuel-Power Transportation Foundation:

* * * I wish to renew the suggestion contained in my letter of September 10, 1928, that somewhere in these pamphlets in the proper space the fact should be brought out that the railroads operating in the State of Ohio are contributing toward the preparation and printing of this material.

There does not seem to me to be any good reason why this fact should not be brought out, and a frank admission should dispel any idea that might be advanced that the railroads are a party to any secret propaganda, and at the same time the roads involved would be given credit in assisting the perfectly legitimate and laudable efforts of the Ohio State Chamber of Commerce. * * *[30]

But the "independent" Foundation did not deem it desirable to reveal in any of its material the source of its funds. An examination of pamphlets published subsequent to the letter from the Pennsylvania Railroad failed to show that this information was ever disclosed to the public.[31] And at the subcommittee's hearings Mr. Wyer testified as follows:

The CHAIRMAN. * * * None of your Foundation pamphlets or advertising circulars ever showed that they were paid for with railroad money?

Mr. WYER. No; nor any of the other sources.[32]

On the other hand the railroads did not discontinue their contributions in order to avoid the suggestion that they were a party to "secret propaganda." Instead, when the original three-year appropriation ran out in 1931, a further and larger amount was contributed.

This time it was Mr. Bernet, now president of the Chesapeake & Ohio, who took the lead in the drive for funds. He urged that $40,000 a year for five years was needed for Mr. Wyer to continue "his program of education."[33] Mr. Bernet's plan was to have the eastern railroads give $20,000 and the western roads a similar amount.[34] The Pennsylvania, New York Central, Baltimore & Ohio, and Chesapeake & Ohio agreed to contribute to the Foundation "since it is performing such a meritorious service for the railroads,"[35] but the only western road interested was the Missouri Pacific. This railroad, which like the Chesapeake & Ohio belonged to the Van Sweringen system, gave the entire $20,000 alloted to the western group.[36] According to the Missouri Pacific vouchers, this money was paid to Mr. Samuel S. Wyer of the Fuel-Power-Transportation Educational Foundation "for services rendered to the Missouri Pacific lines."[37]

[27] Exhibit No. 3492, Hearings, Part XXIII, pp. 10493–10494.
[28] Exhibit No. 3467, ibid., pp. 10479–10480.
[29] Exhibits Nos. 3477, 3480, 3485, ibid., pp. 10486, 10487, 10489; ibid., pp. 10105–10106. In addition to the Pennsylvania, the New York Central, Erie, Nickel Plate, Wheeling & Lake Erie, Wabash, Akron, Canton & Youngstown, Baltimore & Ohio, Chesapeake & Ohio, Norfolk & Western agreed to contribute.
[30] Exhibit No. 3488, Hearings, Part XXIII, p. 10491.
[31] Exhibit No. 3488, ibid., p. 10491.
[32] Ibid., p. 10113.
[33] Exhibit No. 3472, ibid., p. 10483.
[34] Exhibit No. 3471, ibid., p. 10482.
[35] Exhibit No. 3490, ibid., p. 10492.
[36] Ibid., p. 10113.

These increased contributions, like the previous ones, were never revealed to the public.[38] Mr. Wyer contended, however, that such information was immaterial as the railroad donations had no effect on the literature published by the Foundation.[39] In support of this claim he read a letter from a college professor which said:

I had some doubts about the motives behind the thing, but upon my further examination my doubts have been dissipated. I wish to commend you for the excellency of the pamphlets which you are issuing. * * * I have read practically everyone that has come out, and nowhere did I find the first semblance of propaganda, * * *.[40]

Furthermore Mr. Wyer did not believe that either this professor or any other school official would even be interested in knowing who was financing the Foundation, since the material was purely factual.

The CHAIRMAN. You did not let him know, did you, that his doubts were correct? You did not tell him that the railroads and utilities were paying for that? Do you think that those school teachers of Ohio who were so anxious to get this would have put it out to the school children if they knew the utilities and the railroads were paying for it?

Mr. WYER. It would not have made a particle of difference, because they were interested in getting the facts.

The CHAIRMAN. So you do not think they would care whether or not it was put out by the utilities and the railroads?

Senator SHIPSTEAD. They thought it was just valuable information that they ought to have?

Mr. WYER. Yes.

Senator SHIPSTEAD. You did not consider it propaganda?

Mr. WYER. No, sir.[41]

ACTIVITIES OF THE FOUNDATION

The question might well be asked why the Foundation concealed the source of its funds if its publications were not propaganda. A possible answer can be found in an examination of its activities, for it appears that in return for their contributions the railroads did exercise a certain influence over the work of the organization.

The Pennsylvania Railroad, for instance, which had initiated the idea of the Foundation and was responsible for raising its first appropriation, also passed on the material put out by the organization. A letter written by a vice president of the Pennsylvania in September 1928 states:

We return the pamphlets prepared by the Ohio State Chamber of Commerce through its Fuel-Power-Transportation Educational Foundation. * * *

We have gone over these pamphlets from time to time and find them to be generally acceptable.

We referred them to Mr. Ivy L. Lee, Advisor in Publicity, asking him to scrutinize them carefully from a publicity viewpoint, to see that there was nothing of an objectionable nature in any of the material * * *.

We see no reason why the pamphlets, as prepared, should not be distributed by the Ohio Chamber of Commerce, and feel that they will be helpful in the general interest. * * *[42]

[37] Exhibit No. 3476, ibid., p. 10485.
[38] Ibid., p. 10094.
[39] Ibid., pp. 10114–10115.
[40] Ibid., p. 10115.
[41] Idem.
[42] Exhibit No. 3478, ibid., p. 10486.

Another letter to the head of the Foundation says, "We have reviewed the proof copies,"[43] and again, "Thank you very much for the proof copies."[44]

The Chesapeake & Ohio, which solicited the second and much larger contribution from the railroads, also had censorship rights. When agreeing to contribute to the Foundation it did so on condition that "controversial questions as between the railroads or as between coal fields" would not be taken up.[45] According to Mr. Wyer's testimony this request was followed.

The CHAIRMAN. Did you in any of your studies, go into the lake cargo coal rates?

Mr. WYER. No, sir.

The CHAIRMAN. Nothing was said about that?

Mr. WYER. No. * * *

The CHAIRMAN. And the reason you did not go into it was because it was a controversial matter, and Mr. Bernet [of the Chesapeake & Ohio] did not want to go into that?

Mr. WYER. At the beginning we were to keep out of all controversy, so far as interrailroad relationships and interbusiness relationships and intergroup relationships were concerned.

Mr. BROWN (Executive assistant to the subcommittee). The effect of the lake-cargo situation was to close the mines of Ohio and run the mines in West Virginia, in substance, was it not?

Mr. WYER. Well, of course, if the West Virginia view would have prevailed——

Mr. BROWN (interposing). I say, the result of the situation. You were studying transportation in the interests of the State of Ohio, and this situation, which was of advantage to the Chesapeake & Ohio, resulted in shutting the coal mines in Ohio and running them down in West Virginia so that the Chesapeake & Ohio could get the haul of the coal. Is not that so?

Mr. WYER. Yes; there was that bitter controversy between mine operators and the railroads in Ohio.

Mr. BROWN. But your independent organization did not go into something that was of great importance to the——

Mr. WYER (interposing). A great many things we did not go into for lack of time and help.[46]

On the questions which were gone into, the Foundation appears to have violated its stated purpose of presenting "facts only, without conclusions or recommendations."[47] Mr. Wyer's interpretation of this statement may be found in his testimony concerning the Foundation's material on Muscle Shoals.

The CHAIRMAN. * * * Now, in regard to your lecture on Muscle Shoals, was it for or against?

Mr. WYER. No; it merely gave the facts.

The CHAIRMAN. It gave what you thought were the facts.

Mr. WYER. What the Army engineers agreed were the facts. * * *[48]

But included in the material on Muscle Shoals was the following statement:

The agitation for government operation of Muscle Shoals electric power is merely an opening wedge of government ownership for transportation.[49]

Mr. Wyer agreed that conclusion was not based on the findings of fact.

[43] Exhibit No. 3487, ibid., p. 10490.
[44] Exhibit No. 3488, ibid., p. 10491.
[45] Exhibits Nos. 3480, 3477, ibid., pp. 10487, 10486.
[46] Ibid., pp. 10116–10117.
[47] Exhibit No. 3485, ibid., p. 10489.
[48] Ibid., p. 10098.
[49] Exhibit No. 3465, ibid., p. 10476.

The CHAIRMAN. Was the statement made in the findings of the Army engineers that it was the opening wedge for Government ownership?

Mr. WYER. It was not.[50]

Other subjects taken up by Mr. Wyer were reclamation of waste lands, inland waterways, highway competition, coal, oil, electric power, and so forth, and in many instances he drew conclusions which were based on disputable "facts."[51] Furthermore, it is essential that persons receiving so-called factual material know all the circumstances about its origin. But the Fuel-Power-Transportation Educational Foundation never revealed any of its connections.

The CHAIRMAN. * * * All of this propaganda you were putting out with reference to irrigation and reclamation, Muscle Shoals, and these other projects, was put out as coming from an independent source, an impartial and independent source, whereas, I repeat, it was being paid for, in part at least, by the railroads and the public utilities.

Mr. WYER. That is correct.[52]

Mr. Wyer's belief in the impartiality of the Foundation's viewpoint was not shared by all the railroads. Mr. A. J. County, vice president of the Pennsylvania Railroad, in a letter to a fellow officer, said:

All of the pamphlets are of great public interest. The Fundamentals of Transportation Problem is very well prepared, but if this is to be used for educational purposes it might be more acceptable if the different points or facts were presented and the reader or student allowed to draw his conclusions from them, rather than to state views *from such an evident pro-railroad standpoint.*[53]

Evidently there were other criticisms of a similar nature. In 1934 the Foundation changed its name to the "Social-Engineering Fund." The reason for this change was given by Mr. Wyer in a letter to Mr. Bernet:

In order to get away from some of the criticism because of the words "Transportation", "Fuel", and "Power" which stuck out so conspicuously, I have changed the label on our activity to Social-Engineering Fund. This was done at the suggestion of a group of educators in New York City who are very much interested in getting a wider diffusion for the material I have prepared.[54]

[50] Ibid., p. 10099.
[51] Ibid., pp. 10098–10104. Another subject on which the Foundation had definite opinions and conclusions was labor's right to strike. Their pamphlets stated that there is no right to strike against the public. Mr. Wyer continued this in testimony.

"The CHAIRMAN. In other words, no matter how much they were ground down in their labor and how much their wages were ground down, you would say that the public had an interest which would forbid their striking and using the only weapon they had with which to get a better wage?

"Mr. WYER. Yes * * *.

"The CHAIRMAN. I would feel sorry for labor if they were deprived of the right to strike." (Ibid., p. 10118.)

[52] Ibid., p. 10104.
[53] Exhibit No. 3486, ibid., p. 10489. [Italics supplied.]
[54] Exhibit No. 3496, ibid., p. 10495. At the subcommittee's hearings Mr. Wyer was asked to identify the "group of educators in New York City." He was able to recall only one name, that of a professor from a university in Ohio, and the suggestion was given to Mr. Wyer when he met this professor on a train going to New York City. Ibid., pp. 10123–10124.

At the hearings Mr. Wyer also gave a somewhat different explanation of the purpose in renaming his organization.

"The CHAIRMAN. * * * Why was it you changed the name? Was that to lead the people into believing that——

"Mr. WYER (interposing). For the simple reason that we were doing very much that was entirely outside of transportation.

"The CHAIRMAN. Fuel, power; and of course you were also taking up reclamation and irrigation.

"Mr. WYER. The facts are that we have given much more time and much more attention to three things—science, law, and religion—and their slow evolution, than we have to the whole transportation problem.

"The CHAIRMAN. You have changed from transportation over to religion?

"Mr. WYER. I would not say, 'changed to religion.'

"The CHAIRMAN. I mean, your organization.

"Mr. WYER. The whole question deals with social change." (Ibid., pp. 10124–10125.)

Certainly Mr. Wyer's material was received by a large public. In addition to wide distribution of pamphlets, he lectured in the course of four years 865 times to over a quarter of a million persons in school as well as a large number of adults.[55]

A program of education reaching hundreds of thousands of persons can wield a tremendous influence. When such a program is concerned with questions affecting the public interest, it is of the highest importance that the public know all the facts which might have a bearing on the validity of the information it receives. The Fuel-Power-Transportation Educational Foundation by concealing information about the source of its finances was withholding knowledge which affected the nature of its publications, and the railroads while recognizing the "pro-railroad" bias of the Foundation and aware of the danger in not disclosing their contributions, nevertheless continued to support and make use of the Foundation, thereby condoning this method of "secret propaganda."

RAILROADS AND THE TRUCKING INDUSTRY

Among the many problems which have beset the railroads in the last decade none has concerned them more than the growth of competing forms of transportation—particularly the tremendous inroads on their business made by the use of trucks as freight carriers. In 1934 the Western Association of Railway Executives issued the following statement:

> * * * Truck competition has grown steadily until the volume of traffic taken from the rails has assumed serious proportions. Today, an ever-increasing volume of the railroads' most productive tonnage is being transported by truck for an ever-increasing distance. This volume is more important when we recall the fact that almost every dollar of revenue taken by trucks decreases the net rail revenue or adds to the deficit.
>
> The invasion of the long-haul field is particularly serious In the past two or three years, the use of large trailers has made longer hauls by truck more profitable. * * * The tonnage so moving includes butter, tires, fruits and vegetables, canned goods, meats, and other perishables, most of which commodities carry comparatively high rail rate.[56]

By 1938 it was estimated that the "railroads lose at least two billion dollars in revenue annually from freight which moves by highway."[57]

In an economic system founded on the belief that competition is the life of trade, the introduction of new forms of competition is always a potential threat and industries have evolved many methods of meeting such challenges to their business. This section of the report is concerned with one of the methods adopted by various railroads and railroad associations to combat the inroads of the trucking industry. It is not a method designed to meet truck competition by improvement of railroad service. Nor is it a means for adjusting the railroad industry to the fact that there are certain functions for which motor vehicles are especially adapted. Rather, it is a program planned to impede truck and bus competition by the erection and enforcement of legal barriers.

[55] Hearings, Part XXIII, p. 10109.
[56] Exhibit No. 3540–A, Hearings, Part XXIII, p. 10539. See also Exhibit No. 3612, ibid., p. 10602 at p. 10604.
[57] Exhibit No. 3543, ibid., p. 10542. See also ibid., p. 10168.

This program had its beginnings at least as early as 1932. It had two major aims: The enactment of laws and ordinances designed to harass the trucking industry; and the stimulation of enforcement of such laws, ordinances, and regulations.

THE IOWA RAILROADS

A prime mover in the railroads' campaign against the trucking industry was Mr. Joseph H. Hays. For several years prior to 1932 Mr. Hays was general counsel for the Iowa Truckers Association and a member of the executive committee of the Truck Association Executives of America.[58] From his intimate knowledge of the trucking business he arrived at the conclusion that the railroads could do much to offset the growth of the trucking industry if they followed the right program.[59] In 1932 he presented his plan to the six class I railroads in Iowa [60] and in March of that year he was hired by the six roads for a period of 10 months at a salary of $12,000 plus expenses.[61]

On March 10, 1932, Mr. Hays wrote a letter to the president of the Iowa Railways Association in which he defined the purpose of his new job as follows:

> * * * I have been retained * * * to carry on a campaign relative to the coordination of railway and highway transportation.[62]

And in response to his resignation from the Truck Association Executives of America, Mr. Hays received the following letter from the chairman of that organization:

> * * * I am glad to see that your connections with railroads relative to coordination of rail and highway transportation will be most constructive to the best interests of both methods of transportation.[63]

But an outline of the program which Mr. Hays presented to the railroads says nothing about coordinating rail and highway transportation.[64] Instead this document proceeds on the basis of eliminating truck transportation. Mr. Hays proposed to do this by the enforcement of existing laws and the enactment of further laws.[65] After pointing out that the great bulk of freight moved by trucks consisted of automobiles, motor tires, and butter.[66] Mr. Hays suggested the following plan of action:

> Substantially all of the automobile movement * * * can be eliminated by the application and enforcement of existing length limitations. Substantially, all of the butter movement * * * can be eliminated by the application of existing weight laws and city ordinances hereinafter discussed. From 50 to 75% of the tire movement * * * can be eliminated by the application of existing weight limitations and the said city ordinances.
>
> * * * Cities and towns at strategic points at river crossings into Iowa could be induced to enact ordinances which would eliminate the type of trailer necessary for long-haul movement * * *. I believe that the wall of city ordinances along the Mississippi River can be put into effect and enforcement under them well started within 60 days.[67]

[58] Hearings, Part XXIII, p. 10162.
[59] Exhibit No. 3531, ibid., pp. 10519–10522.
[60] Ibid., p. 10162. Chicago & Northwestern; Illinois Central; Chicago, Milwaukee, St. Paul & Pacific; Rock Island; Chicago Great Western; Chicago, Burlington & Quincy.
[61] Exhibits Nos. 3531, 3532, ibid., pp. 10522, 10530.
[62] Exhibit No. 3529, ibid., p. 10518.
[63] Exhibit No. 3530, ibid., p. 10519.
[64] Exhibit No. 3531, ibid., pp. 10519–10522.
[65] Idem.
[66] Exhibit No. 3531, ibid., p. 10520.
[67] Exhibit No. 3531, ibid., p. 10519 at p. 10521.

The first problem in carrying out such a program of enforcement and enactment of laws was pointed out in a letter written by the chairman of the Truck Association Executives of America:

* * * The reaction against the railroads in this section of the country reflecting upon their methods in handling legislative matters will cost them much good will of the shippers who are keenly interested in motor transportation * * *[68]

Mr. Hays' solution of this difficulty was to conceal so far as possible the fact that he was working for the railroads. In a report to the Iowa railroads he said.

It was thought desirable at the outset, that my connection with the railroad industry be kept somewhat confidential. This was found to be impracticable, and I do not attempt to disguise my identity or connections. Part of my work is carried on without any attempt at secrecy; *much of it, however, is more or less under cover.* Under the circumstances prevailing in Iowa, it was my conclusion it was better to allow the actual facts to be known relative to my employment, rather than to operate under the name of some association or as a representative of labor. I concluded that eventually many of the facts would get out, and that it was better to disclose at the outset as much of the truth as was necessary. I have *generally explained that I am engaged in making a thorough study of motor truck transportation and its relationship to railway transportation;* to determine the volume of truck traffic; the direction of its flow; the causes for its growth and continuance; the analysis of possible means of meeting truck competition; and the evaluation of the possibilities of fitting the two services together. This has *given me the opportunity to conduct my activities without question, although the fact that I am also interested in stimulating the enforcement of the law is known by only a limited number of persons, and only those to whom it has been absolutely necessary to impart this information.* In discussing my connections I have been careful to make it clear that I am employed by all the principal lines operating in Iowa, rather than any one individual carrier, in order to avoid possible reactions from a traffic standpoint.[69]

As already noted, Mr. Hays' program was twofold—the enforcement of existing laws and the enactment of new ones. It was in connection with enforcement that Mr. Hays worked "under cover."

Mr. Brown. * * * What part, Mr. Hays, was it that was "more or less under cover"?

Mr. Hays. When I received information or had suspicion, even, that some trucking operation was being illegally conducted, I did what I could to find out how it was conducted and in what respect it was operating in violation of the law.

Mr. Brown. How did you attempt to find that out?

Mr. Hays. In some instances I would ride out on the highway and follow the trucks and observe the operations myself. Sometimes I would go into a filling station or a hamburger staud or some place along the line and make inquiries, without stating whom I represented. It was the nature of the information. If you were going to get it, you simply had to operate in that manner.[70]

Mr. Hays was materially assisted in this "under cover" work by railway staffs, though the concealment of the railroad hand was his work, not theirs. A report submitted by Mr. Hays to his employers outlines the elaborate system he set up for utilizing such assistance.

In frequent instances railway employes in this and other states have occasion to learn of the specific movement of a motor truck to a given destination when they are morally certain that the truck will be overloaded, due to the amount of cargo agreed to be moved. An intelligence system was set up to utilize these contacts. Simple explanations were made as to just how a layman could tell about when a truck is overloaded, and the law was explained by the use of diagrams and

[68] Exhibit No. 3536, ibid., p. 10519.
[69] Exhibit No. 3532, ibid., p. 10522 at p. 10523.
[70] Ibid., p. 10165.

figures. This information was sent to employes in Iowa and Minnesota, particularly, with the idea that reports as to such instances be made by wire to certain designated officials, that the information then be relayed to me, and by me relayed to an inspector covering a sector of the highway over which such truck would be obliged to move, with the description of the truck and time of departure included. Although this plan was not developed to its possible degree of efficiency, we had a number of instances in which the application of the plan was successful, notably among these being the apprehension of a combination at Dubuque at 2 o'clock in the morning, showing an aggregate weight of 66,000 pounds.[71]

After heavy truck movements had been uncovered in this manner, the next step was to get police officers to take action. Mr. Hays encountered considerable difficulty in carrying out this part of the program and to foster enforcement he proposed a system of offering rewards to the police for making arrests.[72]

Mr. Brown. * * * What did you have in mind by a reward system?

Mr. Hays. Well, I thought that oftentimes city officers have so many other things to do that they do not evidence very much interest in the enforcement of laws of that character. I thought it would be a good idea. As a matter of fact, it did not work out.

Mr. Brown. Who was to pay the reward?

Mr. Hays. I thought it would be a good idea for the railroads frankly and openly to offer rewards for the arrest and conviction—that is, nominal rewards—of those guilty of violating the law.

Mr. Brown. Did the railroads cooperate with you in connection with that?

Mr. Hays. They thought that to some extent it might work out. It was perfectly valid but it was not feasible.

* * * * * * *

Mr. Brown. Was there any objection on the part of the railroads that it might not be very well received by the public if the railways were to offer monetary rewards to police officers who arrested truck drivers?

Mr. Hays. There was some question about it. It was not encouraged very enthusiastically.[73]

Instead of offering rewards directly on behalf of the railroads, Mr. Hays subsequently arranged to have them offered as part of a safety campaign put on by the American Automobile Association. He persuaded the association to include the prosecution of truck violators as well as reckless drivers in their safety program, and suggested a system of rewards for arrests.[74] Mr. Hays found this to be a particularly effective means of carrying out his work and described his contribution to it when he said, "I donated the printed posters and reward application blanks."[75]

The second part of the railroad campaign against the trucking industry was the enactment of new ordinances. The most dangerous threat to the railroads was the entrance of trucks in the long-haul field. In order to stop this development, Mr. Hays made the passage of antitrailer ordinances a main objective.

In order to haul sufficient cargo in one unit to make truck transportation profitable in the long haul, it is in almost all instances necessary to use large size trailers. To strike at the operation of these units, I designed a trailer ordinance to prevent excessive loads to be passed by cities and towns, under authority granted to them by an old statute which had never been exercised heretofore. My plan was to set up a wall of these ordinances at the Mississippi River * * *.[76]

[71] Exhibit No. 3532, ibid., p. 10522 at p. 10527.
[72] Exhibit No. 3531, ibid., p. 10519 at p. 10521.
[73] Ibid., pp. 10164–10165.
[74] Exhibit No. 3532, ibid., pp. 10527–10528.
[75] Exhibit No. 3532, ibid., p. 10528.
[76] Exhibit No. 3532, ibid., p. 10526.

The implications of such a program were brought out in Mr. Hays' testimony before this subcommittee.

Mr. BROWN. Your idea seems to have been to erect a tariff wall along the bridges over the Mississippi?

Mr. HAYS. No. I knew from previous examination that the streets over which these trucks were permitted to pass were not competent to carry the weight which had been permitted. Although nothing had been done about it by the cities and towns, we thought it might be helpful if such ordinances were enacted.

Mr. BROWN. Helpful to the railroads?

Mr. HAYS. Yes.

Mr. BROWN. But the idea was, was it not, to have each of the towns at bridge heads over the Mississippi pass ordinances that would prevent the use of heavy trucks?

Mr. HAYS. That was my original idea.

Mr. BROWN. Regardless of what the law of the State might be outside of the municipality, they could not get over the river?

Mr. HAYS. That was my original idea.[77]

The means which were employed in promoting passage of these laws are suggested by what took place in Davenport, Iowa. Here 250 employees directed by the railroads were assigned the task of obtaining signatures to petitions requesting the city council to pass a trailer ordinance,[78] and here under the guise of disinterested taxpayers, the railroads sought support for the ordinance. Mr. Hays in a confidential statement to his employers said:

We have hastily formed an informal Taxpayers' Committee and have four girls working on telephones calling to the attention of the disinterested property owners the problem in question and suggesting that they attend and speak their opinions at the hearing tomorrow evening, *such calls being made as representatives of the Taxpayers' Committee.*[79]

Another type of law which Mr. Hays was interested in enacting was weight ordinances. He found that the chief difficulty in getting towns and cities to pass and enforce weight ordinances was that they could not afford to purchase the scales necessary for weighing the trucks.[80] He therefore hired a salesman for a scales company, Black & Decker Manufacturing Co., bought one set of scales and sent the salesman into certain key towns. The salesman would induce the city council to pass a weight ordinance, and allow the town to use his scales until enough fines had been collected by the community to pay for the purchase of a set of scales.[81] This ingenious scheme was so secret that Mr. Hays did not even include it in his confidential bulletins to the railroads but embodied it in a personal letter to the roads' general solicitors.[82] After outlining the plan, he said:

This man is a salesman for the Black & Decker Company and apparently has no connection with us whatsoever. Railroads cannot in any way be criticized for his activities. * * * His salary will be $250 per month plus expenses. I will pay him and include his expense in my statement.[83]

[77] Ibid., p. 10164.
[78] Exhibit No. 3533, ibid., p. 10530.
[79] Exhibit No. 3533, ibid., p. 10531. [Italics supplied.] See also ibid., pp. 10172–10173.
[80] Exhibit No. 3532, ibid., p. 10526.
[81] Ibid., p. 10174.
[82] Exhibit No. 3534, ibid., p. 10531.
[83] Exhibit No. 3534, ibid., p. 10532.

At this subcommittee's hearings, Mr. Hays acknowledged that while this enterprise was highly successful in stimulating the weighing of trucks[84] it could not be characterized as other than "deceptive."

Mr. BROWN. Whom did he say he represented?
Mr. HAYS. He said he represented the scale company * * *.
Mr. BROWN. Who owned the scales?
Mr. HAYS. We owned the scales.
Mr. BROWN. And by "we" you mean the railroads of Iowa?
Mr. HAYS. Yes, sir.
Mr. BROWN. Did he tell people that the scales belonged to the railroads?
Mr. HAYS. No; I do not think he did.
Mr. BROWN. What did he tell the police officers?
Mr. HAYS. I was not present. I assume he told them he was interested in the passage of ordinances and in the sale of scales.
Mr. BROWN. Do you agree that that was a stark deception, in that case?
Mr. HAYS. In that case; yes, sir.[85]

One other aspect of Mr. Hays' program deserves mention. To promote publicity in favor of the railroads' campaign he retained an experienced newspaper man to put out a publication known as The Transportation Bulletin.[86] This bulletin was furnished free to the newspapers of Iowa and contained largely stories of law violations by truck interests.[87] Mr. Hays reported to the railroads that by this means he had "been able to stimulate the printing and reprinting of a great many stories beneficial to our cause." [88]

The Transportation Bulletin was sent to newspapers without any indication that it was paid for by the railroads or that they had any part in preparing the material.[89] The credit line simply stated that it was a free news service "which has reference to railroads, rail conditions, and facts relative to competitive forms of transportation." [90]

Mr. BROWN. You did not state it was being financed by the Iowa railroads?
Mr. HAYS. No.[91]

When Mr. Hays completed his 10 months' employment period, he submitted a final report to the six railroads which had hired him.[92] There is no word in this entire report to indicate that Mr. Hays had done anything to promote the coordination of rail and highway transportation,[93] although he had repeatedly alleged that this was the purpose for which he was employed.[94] Instead, he stated: "My original objective was to substantially eliminate the long haul movement of automobiles, tires, and butter by motor truck." [95] From the evidence in his possession he believed that he had not only succeeded in this endeavor but had also "practically eliminated" the movement of fruits, vegetables, beverages, and miscellaneous general freight by truck.[96]

[84] Ibid., p. 10175.
[85] Ibid., p. 10173.
[86] Ibid., p. 10176.
[87] Exhibit No. 3536, ibid., p. 10533.
[88] Exhibit No. 3532, ibid., p. 10529.
[89] Exhibits Nos. 3536, 3537, ibid., pp. 10533–10537.
[90] Exhibit No. 3536, ibid., p. 10533.
[91] Ibid., p. 10176.
[92] Exhibit No. 3532, ibid., pp. 10522–10530.
[93] Ibid., p. 10171.
[94] Ibid., pp. 10163, 10171; Exhibits Nos. 3529, 3530, ibid., pp. 10518–10519.
[95] Exhibit No. 3532, ibid., p. 10522.
[96] Idem.

THE WESTERN ASSOCIATION OF RAILWAY EXECUTIVES

Upon completing his work for the Iowa railroads, Mr. Hays suggested to the Western Association of Railway Executives that the campaign against the trucking industry be extended to cover all the Western States.[97] Impressed by the results attained in Iowa, the Association on February 10, 1934, hired Mr. Hays as special counsel to continue and expand his program.[98] The objectives of this body were no different from those of the Iowa railroads, and the Western Association of Railway Executives made no pretense of wishing to "coordinate" rail and highway transportation. A memorandum from their files states:

> It is * * * believed that we can collectively recapture much of the tonnage now being moved by trucks; *that we can retard the growth of the truck industry;* that we can definitely slow up the invasion by the truck into the long-haul field, * * *.[99]

Shortly after Mr. Hays took office he secured the services of Mr. Warren E. Wright, owner of a bail-bond business for motor-vehicle operations.[1] The special advantage of this calling was, as Mr. Hays pointed out in a memorandum to the Western Association of Railway Executives, that "the more motor truck operators who are arrested for violations of the motor-vehicle laws, the greater the demand for his bail-bond service."[2] Obviously, Mr. Wright was ideally suited for launching a law-enforcing drive and, under Mr. Hays' guidance, he promptly embarked on this project.[3]

Mr. Wright also had the advantage of being already acquainted with many of the law-enforcing officials in the Western States; naturally when he called on them, requesting them to take action against truck violators, and gave as his reason "the stimulation of his bail-bond business" they accepted the statement at face value.[4] A more perfect method of disguising the railroads' role in attacking the trucking industry could hardly be evolved, and if, as Mr. Hays agreed, the activities of the scales salesman in Iowa were "stark deception," Mr. Wright's were scarcely less so.

The next year Mr. Wright widened his field of action. The record does not show whether he had given up the bail-bond business but it does show that in September 1935 he became associate editor of The National Constitution.[5] Mr. Wright described this magazine to Mr. Hays as "an independent Republican weekly * * * backed by a group of outstanding middle west men,"[6] and said, "This connection should enable me to make the proper contact in connection with the survey you desire."[7]

The National Constitution at this time was putting out a questionnaire for the purpose of ascertaining public opinion on matters of national policy.[8] Under the guise of distributing this questionnaire Mr. Wright secured entrén to car realers, shippers, and others who were able to furnish information on truck movements.[9] For instance on September 13 Mr. Wright wired Mr. Hays' office as follows:

> California Caravan, 19 hookup, are 38 Lafayette cars. Left Racine 11:00 o'clock this morning. * * * Expect to hit Kansas State Line early Friday morning. Cars are all numbered with white chalk in hookup—1 to 19.[10]

This information was then relayed to railroad officers at strategic points who could take the necessary action in reporting it to State officials who in turn would halt the truck caravans to collect fines or taxes.[11] It will be noted that this strategy had also been employed in the Iowa campaign, but the full expression of its possibilities was brought about through the impersonations of the resourceful Mr. Wright.

The effect of these activities on interstate commerce is revealed in a letter Mr. Hays wrote to the representative of the Western Association of Railway Executives in Kansas. Urging passage of a caravan act in Kansas he said:

> Originally, the caravaners only cut across a short corner of your state in the Southeast. However, the enforcement of the caravan act in Oklahoma and New Mexico and the pending enforcement of the act in Nebraska and the present enforcement of the acts in Wyoming are causing many caravaners to detour through Kansas.[12]

Another member of Mr. Hays' staff was an engineer.[13] In the summer of 1934 he conducted a study of U. S. Highway No. 40 in Kansas and concluded that about 75 percent of the concrete between Kansas City and Topeka had failed as a result of heavy truck traffic.[14] These conclusions were then embodied in a brochure and distributed to the member roads of the Western Association of Railway Executives.[15] The nature of this pamphlet may be judged from a letter written by Mr. Hays:

> When his study was completed I then conferred with an advertising concern here in Chicago, which I have spent some time in educating in a general way. They wrote a résumé of the study, enlarged the photographs, and set out the conclusions in very forceful style. I was a little hesitant about circulating a pamphlet of such a degree of temperature over our signature.[16]

The association might well have hesitated over making public this study, for at the subcommittee's hearings it appeared that the use of trucks had little if anything to do with the failure of the concrete on Highway No. 40.

> Mr. HAYS. * * * You see, many times railroad people will make the statement that the use of heavy trucks is destructive to roads, and then someone will say: Where and when? And the railroad people are pretty hard put to it to be able to cite specific instances. That was a graphic instance. Perhaps Senator Truman is familiar with that highway.
>
> Senator TRUMAN. *Yes, I am familiar with it, and I know why it failed. The concrete mixture was not the proper one.*"[17]

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[97] Exhibits Nos. 3538–3540 A, ibid., pp. 10537–10540.
[98] Exhibit No. 3541, ibid., p. 10541.
[99] Exhibit No. 3540–A, ibid., p. 10540. [Italics supplied.]
[1] Idem.
[2] Idem.
[3] Idem.
[4] Idem.
[5] Exhibit No. 3555, ibid., p. 10552.
[6] Idem.
[7] Idem.
[8] Exhibit No. 3556, ibid., p. 10553.
[9] Exhibits Nos. 3550–3557, ibid., pp. 10550–10554.
[10] Exhibit No. 3551, ibid., pp. 10550–10551.
[11] Exhibits Nos. 3552–4, ibid., pp. 10551–10552.
[12] Exhibit No. 3577, ibid., p. 10570 at p. 10571.
[13] Ibid., p. 10202.
[14] Exhibit No. 3586, ibid., pp. 10576–10577.
[15] Ibid., pp. 10203–10204.
[16] Exhibit No. 3586, ibid., p. 10576 at p. 10577.
[17] Ibid., p. 10202. [Italics supplied.]

The conclusions of the engineer were set forth as impartial and scientific.[18] However, no mention was made of the fact that he was being paid by a partial source, the Western railroads, or that his scientific findings were incomplete.

Mr. BROWN. You did not state that the railroads paid the bill of this engineer, did you?

Mr. HAYS. Certainly not.

Mr. BROWN. You did not discuss the aspect of this highway failure that Senator Truman has brought out?

Mr. HAYS. At the time the pamphlet was printed we did not know those facts.[19]

The lack of candor on the part of railroads is, of course, partially explained by the difficulties that arose when they came out in the open. Through Mr. Hays' organization bills were introduced into several State legislatures providing for heavier taxes on trucks.[20] One such bill was defeated in Iowa because, according to the chief engineer of the Iowa Highway Commission, "the railroads had shown their hands too visibly and that anyone who was at all familiar with the purpose of the bill recognized it as an attempt to legislate the trucks out of business; and that consequently it was defeated almost before it got well under way."[21]

The most violent opposition to the railroads arose over the question of port of entry bills. In March 1935, Mr. Hays and the Western Association of Railway Executives endeavored to get the Iowa State Legislature to pass a port of entry bill. When the bill came up for consideration a business man in Sioux City wrote the Governor of Iowa as follows:

> It is my personal opinion that any member of the legislature or any official of the State who supports this vicious bill will be under suspicion of having been subsidized by interests representing the carriers. This proposed legislation, if enacted, is not enforcible because it is my opinion that the people along the border of the State of Iowa will see that the interstate traffic and commerce proceed without taxation, even though the taxation may be levied by legislation. It is also my opinion that even as Governor of the State of Iowa, with the power to call out the National Guard, you could not enforce this vicious legislation, if it became a law of the State, because you do not have guards enough to surround the border and where the people rebel against injustices, you will be unable to enforce the provisions and the penalties of the bill.[22]

Another letter written at the same time to a member of the Iowa house of representatives by one of his constituents stated:

> The theory of the port of entry bill is unpolitic, unpatriotic, and asinine. With the exemptions now attached to the bill the revenue would be insufficient to pay for the costs of enforcement and I question whether you can pass a piece of legislation of this kind, granting the exemptions scheduled, and have it within the constitution. Later these exemptions will be withdrawn, if you are to realize revenue from the enforcement of this legislature. When that time comes Sioux City might as well close up and let all of the Nebraska business go to Omaha and all of the South Dakota business go to Sioux Falls.
>
> Any intelligent person could see this picture as I have outlined it briefly here and people in Sioux City are wondering who is the sponsor of this legislation. Some people say that it is the railroads and that they have a considerable slush fund to procure the enactment of this bill into a law. If you vote in favor of it you will be voting against the will of your constituency and be under suspicion of benefiting from the slush fund alleged to be available.[23]

[18] Ibid., pp. 10202–10204.
[19] Ibid., p. 10204.
[20] Exhibits Nos. 3573–3580, 3583–3585, ibid., pp. 10569–10573, 10575–10576.
[21] Exhibit No. 3582, ibid., p. 10574 at p. 10575.
[22] Exhibit No. 3579, ibid., p. 10572.
[23] Exhibit No. 3580, ibid., p. 10572 at p. 10573.

At the subcommittee's hearings Mr. Hays discussed the merits of ports of entry.

Mr. HAYS. There was a good deal of objection to those port of entry bills.

Mr. BROWN. Do you mean on the part of local communities?

Mr. HAYS. I would not say on the part of local communities, but there was a good deal of objection on the part of those using the highways for transportation, because ports of entry were very effective in making those using the highways actually pay what they were supposed to pay.

Mr. BROWN. And it had another effect, to set up a tariff wall around the State.

Mr. HAYS. No; although that was the view expressed a good deal by those opposing the bills. They seemed to abhor the idea that they should be made to pay the tax provided by law. * * * I do not see anything wrong with providing efficient machinery to collect such a tax.

Mr. BROWN. But if the tax is different in one State from that in another State, and you start a system by which at the State boundary trucks are stopped, it becomes a tariff wall.

Mr. HAYS. No. * * *

* * * * * * * *

Mr. BROWN. The point here made is not that trucks should not pay proper taxes, but the effect on the movement of interstate commerce by reason of having a series of different taxes enforced by different States at their boundary lines. Is that to your mind an intelligent way to handle the national transportation problem?

Mr. HAYS. I would say this: If any criticism is warranted there, it would be better directed at the way the highways are used by trucks, than at the machinery provided for collecting the proper tax.

Mr. BROWN. But that was not the subject of discussion.

Mr. HAYS. You were discussing ports of entry, which are merely machinery to collect the tax provided by law.

Senator TRUMAN. I think any State that sets up a system of taxation—and you cannot call it anything but a tariff wall—and has at the State boundary a force of men to stop trucks and make them pay a tax, is bad for interstate commerce, and will eventually defeat itself.

Mr. HAYS. Possibly so.[24]

The Iowa port of entry bill, referred to above, subsequently failed of passage because "it was recognized as strictly a railroad bill, and it was defeated mainly through the efforts of the river towns."[25] The natural reaction of the public to suspect the merits of bills introduced by the railroads against their competitors might be considered by some a healthy attitude. The carriers, however, realizing that it impeded their progress preferred to work "under cover." The success of these tactics may be further seen in the Illinois campaign.

THE ILLINOIS RAILROADS

Simultaneously with the general work for the Western Association of Railway Executives, Mr. Hays was carrying on special activities in connection with enforcing and passing ordinances in Illinois. For this work an extra assessment was levied on the Illinois railroads at the rate of $10,000 for 6 months.[26]

Mr. Hays' right-hand man in enforcing existing laws was an ex-sergeant of the Illinois State police.[27] His particular qualification for the job was reported by Mr. Hays.

> He said that he is very well acquainted with the democratic floor leader of the House, at Springfield, and the way he got action from either the License Department of the Secretary of State's office or from the State police, was to have that gentleman go to the offices in Springfield and insist upon action, due to complaints he is *supposed* to have received from his constituents at home.[28]

[24] Ibid., pp. 10195–10196.
[25] Exhibit No. 3581, ibid., p. 10573.
[26] Exhibits Nos. 3544, 3548, ibid., pp. 10543, 10548–10549.
[27] Exhibit No. 3545, ibid., p. 10543.
[28] Ibid., at p. 10544. [Italics supplied.]

Enforcement was also facilitated by the cooperation of executives of the Illinois Central Railroad. These officials interviewed the Governor and other State functionaries who could bring pressure on the chief of State police to enforce existing laws.[29] The extent of their influence is explained in a memorandum from the files of the Western Association of Railway Executives:

> As you know, the Illinois Central has more mileage in Illinois than any other railroad, and Illinois Central officials have considerable political influence due to the unusually large number of employees who are voters in the State.[30]

The enactment of new laws and ordinances in Illinois was carried on through outside organizations under the direction of Mr. Hays. Active in the campaign to secure passage of regulations in 150 Illinois municipalities selected as strategic points[31] were the Railway Employees & Taxpayers Association,[32] Parent Teachers Association,[33] National Safety Council,[34] chambers of commerce,[35] local attorneys[36] and city officials.[37] At the end of 18 months, ordinances were in effect in 17 cities and pending in 48 others.[38] According to a letter in the files of the Western Association of Railway Executives, "scales owned by this organization are now almost constantly in use." [39] The police made 2,001 arrests and collected $21,428.80 in fines.[40]

The results attained by Mr. Hays through "deception," "undercover" activities, work done "in secrecy" and under the guise of other organizations, were considered highly successful by the railroads. The effects not only on the powerful trucking industry but on the small individual trucker may be surmised from the report of one of Mr. Hays' employees, from Wyanet, Ill.

> Local trucker, S. J. Poscharsky, said to be operating livestock truck without state license. Credit bad—in financial distress. Believes two or three arrests would put him out of business.[41]

THE ASSOCIATION OF RAILWAY EXECUTIVES

Western railroads were not the only ones interested in combating the growth of the trucking industry. In 1934 the Association of Railway Executives, a national organization, formed a Division of Competitive Transportation Research to gather and analyze facts pertaining to transportation problems.[42] While these facts were to be of an impartial nature, the object of the division was specifically the "protection of railroads against preferential treatment of trucks and buses." [43]

Information assembled by the division was not for railroads only but was to be made available to everyone, and was to be utilized in "educating" and equipping nonrailroad organizations to take part in

[29] Exhibit No. 3545, ibid., p. 10543 at p. 10544.
[30] Idem.
[31] Exhibit No. 3548, ibid., pp. 10548–10549.
[32] Exhibit No. 3547, ibid., p. 10548.
[33] Idem.
[34] Exhibit No. 3545, ibid., p. 10543 at p. 10545.
[35] Exhibit No. 3546, ibid., pp. 10545–10547.
[36] Idem.
[37] Exhibit No. 3548, ibid., pp. 10548–10549.
[38] Idem.
[39] Exhibit No. 3548, ibid., p. 10549.
[40] Idem.
[41] Exhibit No. 3546, ibid., p. 10545 at p. 10546.
[42] Exhibit No. 3560, ibid., pp. 10557–10559. In October 1934 the Association of Railway Executives became part of the Association of American Railroads. However, the Division of Transportation Research was continued with the same director and the same objectives.
[43] Exhibit No. 3568, ibid., p. 10554.

supporting the railroads' program against the trucking industry, and as a basis for legislation.[44]

The State of New Jersey was selected by the Association as the testing ground for legislation,[45] and in 1934 the Division of Competitive Transportation Research made a study showing the extent to which trucks are subsidized in that State.[46] The study was actually conducted under the auspices of the Association of Railway Executives. The director of the study, however, stated that it was "sponsored by the New Jersey Taxpayers Association" in order "to keep the railroads in the background as much as possible." [47]

On the basis of the study's findings, bills were introduced into the New Jersey legislature providing for ports of entry and increased taxes on trucks.[48] At this point the director of the Competitive Transportation Research Division took on a number of activities which hardly seem to come under the heading of research. He wrote to the Association of American Railroads:

> It has been necessary for me to work with the Taxpayers Association in the preparation of publicity releases concerning this mileage tax legislation. * * *
>
> It has also been necessary for me to call on the managing editors of some of the leading newspapers in New Jersey to explain what a mileage tax on commercial motor vehicles is all about.
>
> Press releases are being prepared in this office about one a week regarding this proposed legislation on trucks, *these articles to be released from the Taxpayers Association*.[49]

Other examples of such activity are to be found in the record.[50]

USE OF NONRAILROAD ORGANIZATIONS

In addition to the railroad organizations themselves, the fight against motor vehicles was carried on by so-called nonrailroad organizations. For instance, the shippers and manufacturers of railroad supplies were active in combating the trucking interests. They organized and incorporated the Shippers and Manufacturers Transportation Association on December 3, 1930, for the purpose of interesting and securing the cooperation of shippers and manufacturers in a solution of the problem of control and regulation of busses and trucks operating upon the public highways through legislation favorable to the railroads.[51]

This organization was started because the industrialists felt the railroads were not in a position to take the lead in fighting truck competition. A confidential statement by the executive committee of the Association in July 1934 describes this attitude.

> Those opposing a program that might be directly undertaken by the Railroads naturally make prejudicial claims and endeavor as far as possible to confuse the real purposes behind the Railroad efforts. A nonpartisan organization of industry such as The Shippers and Manufacturers Transportation Association is entirely exempt from such prejudicial claims and is therefore in much better position to initiate and support a legislative program of this type.[52]

[44] Exhibit No. 3568, ibid., pp. 10564–10565.
[45] Exhibit No. 3568, ibid., pp. 10566–10567.
[46] Idem.
[47] Idem.
[48] Idem.
[49] Idem. Italics supplied.
[50] E. g., Exhibit No. 3566, ibid., pp. 10564–10565.
[51] Exhibits Nos. 3612, 3613, ibid., pp. 10602–10607.
[52] Exhibit No. 3612, ibid., p. 10602. As already noted, however, this "nonpartisan" group was organized by shippers and manufacturers of railroad supplies.

The Association had four divisions dealing with statistics, publicity, legislation, and enforcement.[53] However, as in other organizations discussed, the main objective was the passage and enforcement of legislation.[54] Various methods of cooperating with the railroads on legislative matters were tried out but after 3½ years the association decided that "more effective work" was accomplished when the "Association sponsored the entire legislative program with the Railroad contacts working in the background." [55] The reason for this conclusion was that:

> The success of such an organization as this in the interests of stabilized transportation is singularly effective in that it represents a large group whose interests and concern for proper regulation and control cannot be questioned or considered prejudicial.[56]

The fact that the Association became the sole sponsor of legislation, and the fact that it presented itself as an independent, unprejudiced organization did not deter it from accepting financial support from the railroads.

Regular annual contributions to the "manufacturers and shippers" Association were made by railroads, computed upon a mileage basis.[57] In 1931 three-sevenths of the Association's budget was contributed by the railroads.[58] In addition there were special assessments for particular purposes. For example, in 1932 when the Association planned to do some work with the Kentucky legislature, the Kentucky roads were asked to contribute $3,000.[59] An official of the Louisville & Nashville Railroad in a letter to other Kentucky roads described the work done by the association.

> This Association employed one of the most influential men in the state to go to Frankfort as its representative in this bus and truck fight. He was the former Speaker of the State House of Representatives. I happen to know that they paid him a substantially larger sum than our contribution to their cause, in addition to his expenses.[60]

The chairman of the Association in a letter dated January 7, 1933 indicated that three of the Van Sweringen railroads were contributing $21,800 a year.[61] He also stated that the president of the Missouri Pacific, which was paying $15,000 annually to the Association, intended to cooperate with the Association "for an indefinite period, but in any event, for at least the 5 years commencing January 1, 1933." [62]

In 1934 the Association decided to expand its work and planned a program for 5 years.[63] The finances for that period were worked out as follows:

> The Finance Committee, * * * have definite assurances that the railroad equipment and supply business together with shippers and receivers of freight will contribute 50% of the funds required to carry on this work. The other 50% should be contributed by the Railroads of the United States.[64]

[53] Exhibit No. 3612, ibid., p. 10603.
[54] Exhibit No. 3613, ibid., p. 10606.
[55] Exhibit No. 3612, ibid., p. 10604.
[56] Exhibit No. 3612, ibid., p. 10602.
[57] Exhibit No. 3614, ibid., p. 10607.
[58] Exhibit No. 3613, ibid., p. 10606.
[59] Idem.
[60] Idem.
[61] Exhibit No. 3614, ibid., pp. 10607–10608.
[62] Idem.
[63] Exhibit No. 3612, ibid., p. 10605.
[64] Idem.

An even more inclusive organization than the Shippers and Manufacturers Transportation Association was planned by Mr. Hays in 1934. It occurred to him that the activities of diverse organizations which sprang up in different groups and in different parts of the country to combat trucking would be more effective if they could be consolidated into one organization. Therefore he suggested the formation of a "National Highway Protective Association." [65] In a letter to the chief operating officer of the Akron, Canton & Youngstown Railway Co., Mr. Hays outlined his purpose:

> * * * We are very much interested in establishing an organization of those whose interests are common with our own, and who are anxious to promote safety on the highways to protect our capital investment in highways, to develop sound and stable methods for marketing and distribution, and to do something to prevent the drift toward government ownership and the further socialization of industry. This sounds like a large order, but in plain words we are marshalling our friends to help carry the flag for enforcement and legislation.[66]

Chief among "those whose interests are common with our own," Mr. Hays included the insurance companies. It was his belief that on the basis that enforcement of laws against trucks and busses would reduce death and accident casualties and loss on automobile public liability insurance, the insurance companies would be willing to contribute to the organization.[67] He proved to be correct in this assumption and was successful in securing the cooperation of insurance people.[68]

The National Highway Protective Association plan was eventually abandoned in favor of a national association which would deal with all problems of competing transportation.[69] But the principles on which Mr. Hays had organized the fight against the trucking industry were carried over to the Transportation Association of America. These principles were primarily concerned with hiding the role of the railroads and their interests behind the activities of apparently nonpartisan organizations. As the chairman commented at the subcommittee's hearings:

> I think it entirely proper for the railroads to work in their own interests in an open, honest, and above-board manner. But for the railroads to pay out money to people to say they are representing railroad labor, or railroad investors, when as a matter of fact they are not representing either, I think is entirely improper.[70]

The campaign against the trucking industry was generally considered successful by the railroads. But a different conclusion was drawn by the president of one of the western roads who in a speech to the Western Association of Railway Executives in October 1937 said:

> The railroads have spent millions and millions of dollars in fighting a form of evolution in transportation. The railroad companies, I think, in resisting and trying to hinder, have done more for the trucking business than they could ever have done for themselves. Railroad men have talked to the heads of industries against the truckers so much that they have opened his eyes to the fact that he could use them. * * *[71]

[65] Exhibit No. 3586, ibid., pp. 10576–10577.
[66] Exhibit No. 3591, ibid., p. 10580.
[67] Exhibit No. 3589, ibid., pp. 10578–10579.
[68] Exhibit No. 3594, ibid., pp. 10584–10585.
[69] Ibid., pp. 10205–10207. The Transportation Association of America. For a discussion of its activities see pp. 42–47, infra.
[70] Hearings, Part XXIII, p. 10076.
[71] Exhibit No. 3351, Hearings, Part XXIII, p. 10220.

THE ASSOCIATION OF AMERICAN RAILROADS

The foregoing pages of this report have discussed some examples of the activities of railroads and railroad organizations in years prior to 1934. In that year, however, a new situation arose which affected the subsequent growth and program of railroad associations.

It will be recalled that after the Great War there was much discussion as to whether the railroads should be kept under Federal control or returned to private hands. The decision embodied in the Transportation Act of 1920 was to terminate Government operation. The Transportation Act also provided for the consolidation of the United States railroads into a limited number of systems. But these consolidations were not compulsory; they were to be brought about voluntarily by the railroads. In 13 years no important consolidations had been carried out.[72]

By 1933, 3 years of depression had seriously affected the railroads. Mr. Joseph B. Eastman, an Interstate Commerce Commissioner, was appointed Federal Coordinator of Transportation and asked to make a study of the situation.[73]

ORIGIN OF THE ASSOCIATION

In January 1934, Mr. Eastman issued a report. In this report he laid aside Government ownership and consolidations as immediate solutions of the railroad problem. But the only alternative, he said, was for the railroads to organize themselves so that necessary economies could be effected.[74] He stated:

> It is not too much to hope that the railroads may be able to form a more perfect union to deal with matters of common concern, such as scientific research, the establishment of standards, the adoption of new types of equipment, and new forms of service, the unification of terminal operations, and readjustment of the rate structure.
>
> Much will depend upon the railroad managements. They are of one mind in opposition to public ownership and operation and in general they are against grand consolidation plans. One or the other of these remedies will eventually be applied unless the managements are able to remedy present ills in some other way. This alternative, if it be possible, can only take the form of a better organization of the railroad industry which will enable them to deal collectively and effectively with matters which concern them all. The managements must pull together instead of pulling against each other in a great variety of different directions. The difficulties are great, and I am not at all sure that they can be surmounted. The tendency to cling to assumed individual advantages in preference to those which would be gained by coordination or correlation is ingrained, and, it may be impossible to overcome. But it is well that the managements should have the chance to apply the principles of statesmanship and with the help of the Government, at least at the outset. Much will be learned in the process.[75]

In effect, the coordinator said that since the railroads had rejected Federal control and consolidation plans, it was now up to them to show that under private ownership the industry could be run on a rational rather than individual basis.

The vast maze of railroad associations already in existence was obviously too unwieldy to fulfill such a purpose. In addition there

[72] For a full discussion of this subject see this subcommittee's report entitled, "Railroad Combination in the Eastern Region." (Report No. 1182, Part 2.)
[73] Emergency Railroad Transportation Act of 1933, Title I.
[74] Senate Doc. No. 119, 73d Cong., 1st sess.; Hearings, Part XXIII, p. 10052.
[75] Ibid., pp. 10052–10053.

were many criticisms by railroad executives of the nature of these organizations. As early as 1929, Mr. Mark W. Potter, a director of the Chicago, Milwaukee, St. Paul & Pacific Railroad and a former Interstate Commerce Commissioner, wrote as follows regarding certain groups:

> The so-called traffic associations are unsound in organization, inefficient in activity, and vicious in results. You could not conceive of any group of affiliated industrial interests desiring to maintain a sort of association for common good so ridiculously constituted or operated. There has simply been no way to bring about solidarity and uniformity of policy and no machinery to get up to the chief executives the traffic problem which in this day and generation really present by far the greatest problem and duty of a railroad executive.[76]

The weaknesses of two outstanding organizations in the railroad field, the American Railway Association and the Association of Railway Executives, were pointed out in a memorandum prepared in 1934 by Mr. M. W. Clement, then vice president, now president of the Pennsylvania railroad.

> The fundamental weakness in the American Railway Association and in the Association of Railway Executives is in their organization.
>
> As I have observed the meetings of the Board of Directors of the A. R. A. and the meetings of the Advisory Committee, of the A. R. E., the members of these Boards came to the meetings without having familiarized themselves with the subjects of discussion, and try to dispose of them in thirty minutes or an hour—subjects that perhaps have taken months to prepare and consider. The members of the Association passing upon them are subject to influence (as the subject may affect each particular carrier) and act without having given much consideration to the subject at hand. There is a tendency for this method of doing business extending down through the organization.
>
> The "Directors" of both of these bodies do not come to these meetings as Directors should, with the intent of approving or disapproving of the subject matter, but they come there and debate the subject as administrative officers—which they are not in a position to do—and, further, the officers having created the conclusions and recommendations are not present to explain why they have come to such conclusions and recommendations. Also, on a few occasions, when they did have present the officers who prepared the recommendations, the Directors were not familiar enough with the subject matter or the details to properly pass upon it.
>
> * * * The trouble with the A. R. A. today is the "dead wood" at the top, plus the fact that they have very little mandatory authority to make effective recommendations toward standardizing practices.[77]

The problem, therefore, was to form one strong, all-inclusive association, organized in such a way that it would have the power to make and carry out decisions with regard to the welfare of the industry as a whole.

The reaction of railroad men to Mr. Eastman's report was that he had "issued a really ringing challenge to the industry"[78] to form a body which could regulate the railroads—a challenge which, if accepted, would end "further talk of government ownership and operation" and "further effort to extend the influence of the government over railroad operations, particularly in the field of management."[79] However, the driving force behind accepting Mr. Eastman's proposal did not come from railroad executives themselves but from those who were financially interested in railroads.

[76] Exhibit No. 3439, ibid., p. 10438.
[77] Exhibit No. 3436, ibid., pp. 10433–10434.
[78] Exhibit No. 3444, ibid., p. 10450 at p. 10451.
[79] Exhibit No. 3444, ibid., p. 10450 at p. 10453.

In 1933 the president of the Security Owners Association began a movement to secure the cooperation of railroad directors with investors in facing the problems created by the depression.[80] His efforts culminated in the selection of a Directors-Investors committee of nine financiers who were also directors of various railroads.[81] These men were apparently close to J. P. Morgan & Co. and relied on partners of that firm for advice.[82]

It was this committee which, upon publication of Mr. Eastman's report, promptly decided that it was particularly well qualified to promote the organization of a strong railroad association. One of the members of the committee commented on the Coordinator's report as follows:

> The need of a stronger organization of the industry is urged so strongly that I have little doubt that the executives are giving the matter their consideration. * * * The gist of my idea is that a constructive thing for our committee to do would be to take a real interest in the consideration of this suggested development, putting our weight behind the idea of having this challenge promptly met by the railroads with that display of "statesmanship" which Mr. Eastman calls for. I do not think there could be a stronger move by the railroads at this juncture than a prompt public announcement that they would act at once upon the Coordinator's suggestion and "form a more perfect union to deal with matters of common concern" * * *.[83]

Another director said:

> I agree with you entirely that Mr. Eastman has issued an invitation to those interested in new railroad legislation to offer constructive suggestions, and I also feel that our own Committee is better able to initiate a move in this direction than any other.[84]

Mr. Fairman R. Dick, one of the members of the directors-investors group, testified at this subcommittee's hearings that it was the unanimous opinion of the committee that they urge the railroad executives to form a strong railroad organization.[85] For several months discussions were had between the committee, the coordinator, railroad bankers, railroad executives and railroad organizations already in existence.[86] Various plans were drawn up,[87] and finally in October 1934 the Association of American Railroads was incorporated.[88]

The true significance of this move, according to one director, was that it signalized the renewed intention of the railroads "to deal constructively and hopefully with every possible phase of the whole problem of the industry." [89] The railroads were acknowledged to be facing a serious crisis, perhaps the most acute in their history,[90] and in accepting Mr. Eastman's challenge they had an opportunity to prove their faith in the ability of private management to "put aside petty and selfish considerations and realize their welfare is inextricably interwoven with the public welfare." [91]

[80] Ibid., p. 10050.
[81] Ibid., p. 10060. At hearings in October 1938 before the emergency board appointed to investigate a controversy between carriers and their employees regarding a wage reduction, Mr. Pelley, president of the Association of American Railroads, denied that the members of this committee were bankers. (Ibid., p. 10052.) However the committee included the head of a banking house, an investment broker, a member of the executive committee of Guaranty Trust Co., and directors of Chase National Bank, Equitable Trust Co., United States Trust Co., and First National Bank of New York. (Ibid., p. 10051.) Mr. Pelley was quite right in stating that all these men were railroad directors but it seems equally clear that they were also financial men.
[82] Exhibits Nos. 3426, 3432, Hearings, Part XXIII, pp. 10417–10418, 10425.
[83] Exhibit No. 3421, Ibid., p. 10412.
[84] Exhibit No. 3422, Ibid., p. 10413.
[85] Ibid., p. 10053.
[86] Exhibits Nos. 3423, 3424, 3426, 3432, 3433, 3434, Ibid., pp. 10415–10416, 10417–10418, 10425–10428.
[87] Exhibits Nos. 3425, 3427–3429, 3431, 3435, 3436, 3438, Ibid., pp. 10416–10417, 10418–10423, 10424, 10425, 10428, 10435, 10346–10438.
[88] Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 76th Cong., 1st sess., on H. R. 2531, vol. I, pp. 310–311.
[89] Exhibit No. 3427, Hearings, Part XXIII, p. 10418.
[90] Exhibits Nos. 3426, 3519, ibid., pp. 10418, 10509.

SELF-REGULATION

The Association's plan of organization outlined many fields of activity, but the basic theme of the plan and the end to be achieved in all phases of its work was self-regulation.

> It was the hope of those who conceived this plan of organization and government that the industry would demonstrate its capacity for self-regulation and, therefore, make it unnecessary for government authority to intervene in railroad affairs.[92]

Therefore in the preliminary discussions concerning the Association of American Railroads, much attention was given to the question of the kind of machinery necessary for a system of self-government. Mr. M. W. Clement, vice president of the Pennsylvania railroad, pointed out that the trouble with previous organizations was that they had little "mandatory authority" to carry out recommendations, and that the new Association would have to be given more power if its work were to be effective.[93] Similarly Mr. R. H. Aishton, chairman of the Association of Railway Executives and long familiar with railroad associations, said that the chief question to be decided about the Association of American Railroads was whether the carriers would "give a national organization the power of self-government of the industry, with the necessary authority and power to enforce findings." [94]

When the plan of organization was finally drawn up, it did delegate the power of self-government to the Association but it did not contain any provisions for enforcing such power. Instead it was decided that railroads would voluntarily cooperate in carrying out decisions of the Association.

> There are no penalties in the plan for refusing to comply with the orders of the Board of Directors, reliance being had upon the signed obligation of the railroad to comply with such orders as long as the railroad remains a member of the Association. The success of the organization will depend, naturally, on the spirit in which its policies are carried out by the important roads.[95]

Although it was this very theory which had not worked before, perhaps it was believed that in view of the serious situation now facing the railroads they would change their attitude. Certainly the fact that 99 percent of the mileage of Class I railroads belonged to the Association [96] meant that if the member railroads did comply with the orders of the Association, its decisions would be binding on practically every road in the United States. And, as it worked out in practice, the efficacy of the Association as a medium of self-regulation was not so much hampered by the lack of enforcing power as by other factors.

[91] Exhibit No. 3444, ibid., p. 10450 at p. 10453.
[92] Exhibit No. 3444, ibid., p. 10450 at p. 10452.
[93] Exhibit No. 3436, ibid., p. 10433 at p. 10434.
[94] Exhibit No. 3438, ibid., p. 10436 at p. 10437.
[95] Exhibit No. 3444, ibid., p. 10450 at p. 10455.
[96] Ibid., p. 10681. This is equivalent to about 95 percent of the total mileage in the United States. See Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 76th Cong., 1st sess., on H. R. 2531, Volume I, p. 309.

1. *Freight rate divisions.*—An important problem in the railroad field is the question of freight-rate divisions. An explanation of the meaning of this term was brought out in the testimony of Mr. William Schindele, auditor for the Wabash Railway Co.

Mr. HILMER (assistant counsel to the subcommittee). * * * When goods are shipped by railway, the shipment is carried frequently by more than a single railroad?

Mr. SCHINDELE. Yes.

Mr. HILMER. The railroad to which the shipper turns over the goods for shipment is called the originating carrier?

Mr. SCHINDELE. Yes.

Mr. HILMER. If the goods are shipped to some point beyond the line of the originating carrier, the freight car is carried by one or more other railroads until it is finally delivered at the point of destination?

Mr. SCHINDELE. Correct.

Mr. HILMER. The railroad which makes the final haul to the point of destination is called the destination carrier?

Mr. SCHINDELE. Correct.

Mr. HILMER. The freight charge for the entire haul is received in full either by the destination carrier or, in cases where the freight is prepaid, it is received by the originating carrier?

Mr. SCHINDELE. Correct.

Mr. HILMER. But all the railroads which have any part in carrying the shipment are entitled to a portion of the total freight charge?

Mr. SCHINDELE. Correct.

Mr. HILMER. The division of those freight charges among the various railroads which participate in the haul is called the division of rates?

Mr. SCHINDELE. That is right.

Mr. HILMER. The division of rates is ordinarily based on agreements between the carriers, filed with the Interstate Commerce Commission?

Mr. SCHINDELE. Correct.[97]

The decision as to what proportion of a through transcontinental rate should accrue to each carrier which forms part of the through route has been a subject of controversy for many years.[98] According to testimony and exhibits introduced at the subcommittee's hearings, eastern roads received 27½ percent of the rate, western transcontinental lines such as the Union Pacific, Great Northern, and Northern Pacific, received 60½ percent,[99] while the midwestern trunk lines sandwiched in between received only 12 percent although their mileage is 22 percent.[1]

Mr. Fred W. Sargent and Mr. Patrick H. Joyce, presidents, respectively, of the Chicago & North Western Railway Co. and the Chicago Great Western, two roads classed as midwestern trunk lines,[2] testified that they considered the division of rates fair for the eastern carriers but unfair to the midwestern trunk lines as opposed to the western transcontinental lines.

Mr. BROWN. Is it your opinion, Mr. Sargent, that the division of rates is roughly fair for the eastern carriers but unfavorable to your carriers, I mean as against the western transcontinental lines?

Mr. SARGENT. I think it is relatively fair for the eastern carriers * * *.

Mr. BROWN. * * * That question was, whether you thought the division with the western transcontinental lines, that is, with the Union Pacific and the Great Northern, is fair.

[97] Hearings, Part XXII, p. 9600.
[98] Exhibit No. 3359, Hearings, Part XXIII, pp. 10320–10342.
[99] Ibid., p. 9967.
[1] Ibid., p. 9968. All roads in that group get the same rate divisions of the through transcontinential traffic.

Mr. SARGENT. I think it is decidedly unfair. * * *.

* * * * * * *

Mr. BROWN. Mr. Joyce, do you also agree that the divisions are unfavorable?

Mr. JOYCE. We think they are very unfavorable.[3]

At the time of the subcommittee's hearings, March 1938, there were only two railroads in the midwestern trunk-line territory which were not bankrupt.[4] A very considerable part of the traffic of roads in that territory is transcontinental freight received from connecting carriers[5] and Mr. Sargent stated that he believed the division situation was one factor contributing to the bankrupt condition of the western roads,[6] while Mr. Joyce thought that a fair rate division would have kept the roads out of receivership at least for a while and possibly could have prevented bankruptcy altogether.[7]

If freight rates are so important and if rate divisions are largely arrived at by negotiated agreements among the railroads themselves,[8] why have not the individual roads challenged the agreements? The answer, according to Mr. Sargent, is that it is a "delicate thing" to do because the originating carrier may then take the traffic away from the protesting road.

Mr. BROWN. Why is it delicate?

Mr. SARGENT. Well, there is a tendency for a diversion of traffic.

Mr. BROWN. You mean, if you do not like the divisions and start complaining about them, you are afraid the western transcontinental lines will divert traffic?

Mr. SARGENT. That has been the fear of traffic men.

* * * * * * *

Mr. BROWN. I judge from your former statement, that it was a delicate matter to challenge divisions, that a railroad would be afraid to do it because it would be routed against; and you must have been representing the feeling among many railroad men that the originating carrier has a very considerable power to divert traffic?

Mr. SARGENT. I think they have felt that way.

Mr. BROWN. And you feel that way yourself?

Mr. SARGENT. Yes, sir.

Mr. BROWN. Mr. Joyce, do you feel that way?

Mr. JOYCE. Yes, sir.[5]

If an individual road jeopardizes its position by complaining, the question then arises as to whether the western trunk lines can act as a unit in protesting divisions which are equally unfair to them all. But apparently there were also difficulties in that line of action.

The two western trunk-line roads which were not bankrupt were the Illinois Central and the Chicago, Burlington & Quincy.[10] The former is controlled by the Union Pacific and the latter by the Great Northern and Northern Pacific, all three companies being western transcontinental lines. Their influence on the situation was brought out in the following testimony:

Mr. BROWN. Mr. Sargent, it seems in the case of the Illinois Central, one of the two railroads in western trunk-line territory which is not bankrupt, that the Union Pacific owns upwards of 350,000 shares of common stock directly and in-

[3] Ibid., pp. 9967–9968.
[4] Ibid., pp. 9968–9969.
[5] Ibid., p. 9966.
[6] Ibid., p. 9960.
[7] Idem.
[8] Ibid., p. 9970.
[9] Ibid., pp. 9970–9971.
[10] Ibid., p. 9968.

directly, and 80,000 shares of preferred stock, which amounts to 31 percent of voting control. Do you think that the Union Pacific's control of the Illinois Central has been in any way contributory to keeping the Illinois Central a better carrier than other railroads in western trunk-line territory?

Mr. SARGENT. Well, I very much dislike to express any definite opinion on that. I do not know. I know that when the divisions case was up, and what was known as our divisions case was started, which was about the time I first became president of our properties, in 1925, we made a settlement on the 16½ percent basis at that time * * *[11] The case, however, was never closed. * * * It was finally reopened for hearing in Los Angeles. I am advised that at that time the Illinois Central announced they would not put in any testimony, and were not to be a party to any further proceeding for higher divisions than 16½ percent. * * *

Mr. BROWN (interposing). Excuse me a moment. Do you mean that all railroads in western trunk-line territory applied for a better division, and that when the process was going along, all of a sudden one of the big railroads, the Illinois Central, torpedoed the whole plan by walking out?

Mr. SARGENT. I would not say they torpedoed the proceeding, but they announced they would not proceed with the case.

Mr. BROWN. Did you find that action very injurious in your attempts to get better divisions?

Mr. SARGENT. Our people felt so. * * *

* * * * * * *

Mr. BROWN. It is also a fact that that might have had some bearing on the Chicago, Burlington & Quincy, the other railroad not in bankruptcy, that it is completely owned by the Great Northern and Northern Pacific; or don't you think that has had anything to do with keeping the Burlington in a better financial condition, in better financial health?

Mr. SARGENT. I think that has had something to do with it. I think they get a great volume of the Northern Pacific business without solicitation. * * *[12]

In other words, the Illinois Central and the Burlington being owned financially by the western transcontinental lines were working in their interests rather than the interests of the mid-western trunk lines group to which they belonged geographically.

Since the solution of the rate divisions problem has been described as one of the "crying needs" of the roads in the West,[13] and since it is difficult for these roads to settle the question themselves, this would appear to be a very proper subject for the Association of American Railroads to consider. And indeed the specific question of rate divisions was discussed by the Association in drawing up its plan for arbitration of disputes among member roads.[14] Mr. Fletcher, counsel to the Association, said:

* * * It is, of course, perfectly obvious that railroads cannot get together and shorten the arm of the Interstate Commerce Commission nor deprive the Commission of the jurisdiction conferred upon it by law in a matter involving divisions, or any other subject for that matter. However, I would suppose that the railroads might agree and be bound at least by a gentleman's agreement that when they disagree about divisions they will submit the matter to arbitration and not go to the Commission with the controversy. If a railroad sees proper to break the agreement and file an application with the Commission certainly the application could not be defeated by showing that an agreement had been entered into not to appeal to the Commission. Such a railroad would simply be outside the pale and be guilty of breaking its agreement.[15]

At the subcommittee's hearings presidents of two of the member roads in the A. A. R. testified on their experience in securing assistance through the machinery of the A. A. R. on rate divisions.

[11] The western trunk lines get 16½ percent of the rate after the eastern lines have taken their 27½ percent. This amounts to 12 percent of the through rate. (Ibid., p. 9967.)
[12] Ibid., pp. 9969–9970.
[13] Ibid., p. 9976.
[14] Ibid., pp. 9973–9974.
[15] Exhibit No. 3350, ibid., p. 10218.

Mr. Sargent, president of the Chicago North Western, said that he had never considered using the Association of American Railroads' arbitration machinery because he believed it would be useless. Most of the directors of the Association are connected with the eastern and far western roads.[16] Asking them to readjust the rates at their own expense for the benefit of the middle western roads would be impossible in Mr. Sargent's opinion.

Mr. BROWN. Did you ever feel that you could use that arbitration provision, Mr. Sargent?

Mr. SARGENT. Not on divisions.

Mr. BROWN. Well, why not?

Mr. SARGENT. Because of the make-up of your board of directors. * * *

Mr. BROWN. * * * You cannot use the arbitration machinery of the Association because it is dominated in your mind by the people who would be asked to give up something. Is that the reason?

Mr. SARGENT. I think so.

Mr. BROWN. In other words, you do not feel it is an impartial association of all the railroads?

Mr. SARGENT. Not when it comes to that particular subject.

Mr. BROWN. Well, that is a rather important subject, is it not?

Mr. SARGENT. It is very important to us.

Mr. BROWN. Do you feel there are other subjects also?

Mr. SARGENT. I think it would be simply a waste of time to undertake to put through a process of arbitration, and through arbitration undertake to persuade the transcontinental railroads of the West, and the trunk-line railroads in the Central Freight Association east of us, to give us any more of their revenues.

Mr. BROWN. In other words, to go through the form of association arbitration would be merely begging particular carriers concerned to give you something. The Association is not divided up fairly insofar as the Great Western and the North Western, on the one hand, and the Union Pacific and the eastern trunk lines on the other, are concerned.

Mr. SARGENT. No.

Mr. BROWN. It is these railroads themselves in another form, is that your opinion?

Mr. SARGENT. That is my opinion. * * *[17]

Mr. Joyce, president of the Chicago Great Western, believed that not only the directors of the Association were opposed to changing the divisions but that the method of voting in the Association made it clearly impossible to obtain any satisfaction.

Mr. BROWN. One of the defects in your Association is that you vote on a mileage basis; is it not?

Mr. JOYCE. On the basis that "miles make right." On certain other matters we vote as individuals, but my opinion of the Association is that in the matter of miles making right, and miles dominating the thing, that possibly on a good plan, such as we have here, you cannot get to first base. * * *[18]

Like Mr. Sargent, Mr. Joyce had not made any attempt to use the arbitration setup, but the Chicago Great Western did take up the matter informally with the Association of American Railroads. The attitude of the Association was described by Mr. Joyce.

Mr. JOYCE. * * * I would like to add that this thing has been taken up verbally before the directors of the Association of American Railroads by our Mr. Parsons on two occasions, and, as Mr. Sargent has stated, the people who were on the board were directly concerned about the thing, and they were looking out the window when we were trying to discuss it with them, and they adjourned the meeting in our faces when we wanted them to take it up.

Mr. BROWN. Who adjourned the meeting?

[16] Ibid., p. 9980.
[17] Ibid., pp. 9974–9975.
[18] Ibid., p. 9976. Mr. Joyce was referring to a plan to readjust rate divisions.

Mr. JOYCE. Well, I would not like to attempt to say. I was not feeling very happy, so I did not pay much attention to who was closing the door in my face, and just got out.[19]

On November 16, 1937, Mr. Joyce wrote a letter to Mr. Pelley, president of the Association of American Railroads, pointing out the serious nature of the divisions question, the fact that it was a problem which could be solved by the railroads as a body and that the Association should be an ideal forum for airing such disputes.[20] Mr. Pelley's reply to this letter was:

These suggestions were considered by the Board at its meeting in Chicago last Thursday, November 18th, at which time you participated in a discussion, and you are, of course, familiar with the conclusions reached at that time.[21]

At the subcommittee's hearings Mr. Joyce was asked what these conclusions were.

Mr. BROWN. What did the board say, or what did the directors of the Association say?

Mr. JOYCE. Well, that was one of the times they adjourned.

Mr. LOWENTHAL. Do you mean they adjourned without reaching a conclusion?

Mr. JOYCE. There was no conclusion reached. It was just a case of nothing being done.

Mr. LOWENTHAL. Did they give you a chance to talk?

Mr. JOYCE. Yes; they gave us a chance to talk, but they did not listen. I was talking to myself most of the time.[22]

Mr. Pelley, who was present at the hearings, was asked why the Association refused to concern itself with the division of freight rates. His reply was that the Association was not concerned with the welfare of individual roads but with the welfare of the industry as a whole.

Mr. PELLEY. * * * What we are interested in primarily is doing something for the railroads as a group, not one railroad against another. Suppose you rearranged these divisions; you have not helped the railroad industry as a whole at all. You have not put any more revenue into the railroads' treasury.[23]

Mr. Pelley's explanation fails to take into consideration the most fundamental fact of the railroad problem—namely, that "the railroads are interrelated and *mutually dependent* parts of a national transportation system." [24] The troubles of individual roads weaken the industry as a whole and strengthening the weak roads affects the whole system. Even if a readjustment of rate divisions does not increase the aggregate revenues of railroads, it strengthens the weak carriers, and thus accomplishes benefits for the American railroad system. Furthermore, the Association of American Railroads in stressing its belief that the railroads could settle all their problems without government interference, drew no distinction between individual roads' problems and others. Yet on the important question of divisions it proved impotent and, according to its president, was not even interested.

[19] Ibid., p. 9975.
[20] Exhibit No. 3352, ibid., p. 10221.
[21] Exhibit No. 3353, ibid., p. 10222.
[22] Ibid., p. 9977.
[23] Ibid., p. 9980.
[24] Exhibit No. 3359, ibid., p. 10320 at p. 10340. [Italics supplied.]

2. *Private car lines.*—Another problem confronting the railroads is the charges for private mileage cars. Special refrigerator cars and tank cars for oil and gasoline are owned privately by companies which rent these cars to the railroads at a charge of two cents per mile, whether loaded or empty.[25] In addition the railroads pay for all the running repairs on the private cars.[26] Many railroad executives have felt that they were being exploited by the private car companies, paying excessive charges while the owners of the cars reap handsome profits.[27] This view was expressed by one railroad president in the following testimony:

* * * We are paying 2 cents a mile for these cars, loaded and empty, which I believe is too much. There are 387,000 of these cars in the United States, and last year the railroads paid them $90,000,000, an average of $316 per car. Many of the cars are old and antiquated and almost rusted out. Perhaps a fair average value would only be $2,000 a car. That is almost a 15 percent return. The companies that own these cars are making nice, handsome profits, while the railroads are suffering for just enough money to pay their own employees and buy materials and supplies.

* * * * * * *

There is another terrific waste in this matter, and that is that in times of depression these cars are routed all around Robin Hood's barn in order to earn mileage. * * * We ought to have a rule which would provide that we would not pay mileage on these refrigerator cars except for the shortest mileage, and then if they wanted to route them all around the country they would not get this mileage for the long route. They would be paid for the shortest mileage between two given points.[28]

The profits accruing to the private car companies may be estimated by examining the huge dividends paid by the Pacific Fruit Express, the largest company, operating over one-third of the total private car mileage in the country.[29] Between 1930 and 1936 the Pacific Fruit Express paid almost $120,000,000 in dividends and the dividend rate reported by the company ranged from 30 percent to 103 percent.[30] These profits, according to the president of the Chicago Northwestern, were made at the expense of the railroads.

Mr. BROWN. Those tremendous earnings of the Pacific Fruit Express were made ont of the railroads themselves, not out of the shippers; is not that so?

Mr. SARGENT. Yes.[31]

Private car traffic is a large part of the business of many carriers,[32] and the arrangements for furnishing private cars to railroads has long been one of the concerns of railroad organizations. In 1931 the American Railway Association ordered a general committee to conduct an investigation that would bring about a revision in the mileage rate paid on private cars.[33] In March 1933 this committee recom-

[25] Ibid., p. 9987.
[26] Ibid., pp. 10008, 10641–10642.
[27] Ibid., pp. 9968, 9988, 9996, Exhibits Nos. 3355, 3359, 3360, 3374, ibid., pp. 10223, 10323, 10345, 10357.
[28] Ibid., pp. 9987–9988.
[29] Ibid., pp. 10005–10006.
[30] Exhibits Nos. 3372, 3373, ibid., pp. 10352–10353.
[31] Ibid., p. 10007.
[32] Ibid., pp. 9998–9999.
[33] Exhibit No. 3360, ibid., p. 10345.

mended that the rate be reduced from 2 cents to 1¾ cents per mile.[34] This recommendation, however, was never carried out.[35]

In 1935 the Association of American Railroads made a study of shipper-owned refrigerator cars and authorized a reduction from 2 cents to 1½ cents per mile.[36] The owners of the cars objected to this rate and finally a compromise settlement of 1¾ cents was made.[37]

In the same year the A. A. R. made a "study of the cost of ownership of all types of privately owned equipment, including refrigerator cars other than shipper-owned."[38] On the basis of this study the Association recommended that the rates could not be lowered.[39] However, the report also said:

> In order to get a more complete and representative picture as to ownership costs for this class of equipment, it is the recommendation of the Special Committee that a further study be made covering the year 1935.[40]

But this study was never made because certain of the directors of the A. A. R. objected.[41] Their relationship to the private car companies was brought out in testimony before this subcommittee.

> Mr. LOWENTHAL. Why do not the railroads own these refrigerator cars themselves?
>
> Mr. SARGENT. Many of them do. The Pacific Fruit Express is owned by the Southern Pacific and the Union Pacific.
>
> Mr. LOWENTHAL. They own them through another corporation. The Southern Pacific itself does not own them does it?
>
> Mr. SARGENT. That is right. Then we have the Fruit Growers Express, owned by a number of railroads in the East.
>
> * * * * * * *
>
> Mr. LOWENTHAL. Are there connections between some of the leading directors of the Association and some of the private car companies, directly or indirectly?
>
> Mr. SARGENT. Hale Holden is a director of the Southern Pacific and the Union Pacific, interested in the Pacific Fruit Express. Mr. Gray of the Union Pacific is a director. The Pennsylvania Railroad is the principal owner in the Fruit Growers Express. Mr. Clement is a director. The Atchison, Topeka & Santa Fe have a large ownership of refrigerator cars, and Mr. Bledsoe is a director. There you are. * * *[42]

An example of the financial interest these directors had in the private car companies may be found by examining the returns of the Pacific Fruit Express Co. This company was owned jointly by the Southern Pacific railroad and the Union Pacific railroad.[43] In the years 1930 to 1936 the Southern Pacific received dividends from the Pacific Fruit Express totaling $70,233,269 and the Union Pacific

[34] Ibid., p. 9999.
[35] Ibid., p. 10000, Exhibit No. 3362, ibid., pp. 10346–10347.
[36] In August 1933 the Interstate Commerce Commission investigated mileage rates. One of the witnesses was Mr. George C. Randall who had directed the American Railway Association study. Part of his testimony was as follows:
"Q. Will you explain why, having made this elaborate study and having been advised of this investigation by the Interstate Commerce Commission, you did not come forward and voluntarily offer this study to the Commission for its guidance? Why not?
"A. Because the report is made for the Board of Directors of the American Railway Association, and was presented to the Board of Directors.
"Q. What did the Board of Directors do with it?
"A. That is a matter of record.
"Q. What did the Board of Directors do with it?
"A. They put it on the table.
"Q. They did not approve it?
"A. That is correct." (I. C. C. Investigation and Suspension Docket 3887, pp. 2497–2491.)
[37] Ibid., p. 10001 Exhibit No. 3363, Hearings, Part XXIII, p. 10348.
[38] Ibid., p. 10002.
[39] Exhibit No. 3363, ibid., p. 10348.
[40] Ibid., p. 1002.
[41] Ibid., p. 10003, Exhibit No. 3365, ibid., pp. 10349–10350.
[42] Ibid., pp. 9988–9989.
[43] Ibid., p. 10004.

received $48,510,132.[44] These dividends constituted the following percentages of the net incomes of the two roads:[45]

	Southern Pacific	Union Pacific		Southern Pacific	Union Pacific
	Percent	*Percent*		*Percent*	*Percent*
1930	28	13.0	1934	48	34.0
1931	27	17.0	1935	63	32.0
1932	63	39.0	1936	49	24.5
1933	65	39.0			

Railroads with such a stake in the revenues of private car companies were hardly in a position to consider objectively a possible reduction of mileage rates. When Mr. Carl R. Gray, president of the Union Pacific which owned half the Pacific Fruit Express, and one of the directors of the Association of American Railroads,[46] heard that the Association was planning to make another study of private car rates, he wrote as follows to Mr. Pelley:

> * * * The compilation of these figures for 1934 cost the railroad controlled refrigerator car lines a great deal of money, and I sincerely hope that it will not be necessary to require this work to be done over again for 1935 at approximately the same expense.[47]

Three weeks later, Mr. S. T. Bledsoe, president of the Santa Fe Railroad which owned the third largest fleet of railroad-controlled refrigerator cars, and also a director of the A. A. R.,[48] sent a telegram to Mr. Pelley:

> I concur with Mr. Gray in his protest against proposed compilation of railroad controlled refrigerator car lines data for the year 1935. I also regard such compilation as inadvisable for other reasons some of which at least are known to you.[49]

At the subcommittee's hearings Mr. Pelley was unable to recall what the "other reasons" were to which Mr. Bledsoe referred.[50] He did remember however that he sent the following telegram in reply to Mr. Bledsoe's:

> Executive Committee agree with yourself and Mr. Gray relative inadvisability compiling railroad controlled refrigerator lines data for nineteen thirty-five and it will not be done at this time.[51]

The resolution of the executive committee read:

> After consideration, it was unanimously decided to instruct Vice President Symes to not compile statistics covering cost of operation in 1935 of equipment of railroad controlled refrigerator car lines.[52]

These documents were introduced at the subcommittee's hearings on March 16, 1938, and were identified and verified by Mr. Pelley, who was present as a witness.[53] Seven months later, on October 15, 1938, Mr. Pelley appeared as a witness before an emergency board appointed to investigate and report on certain differences between

[44] Ibid., p. 10006.
[45] Idem.
[46] Ibid., p. 10003.
[47] Exhibit No. 3366, ibid., p. 10350.
[48] Ibid., p. 10004.
[49] Exhibit No. 3367, ibid., p. 10350.
[50] Ibid., p. 10004.
[51] Exhibit No. 3368, ibid., p. 10350.
[52] Exhibit No. 3369, ibid., p. 10351.
[53] Ibid., pp. 10003–10005.

the carriers and their employees regarding a proposed wage reduction.[54] At this time Mr. Pelley denied vigorously that the Association had not compiled the study of 1935.

> Q. (By Mr. LOWENTHAL.) Are you acquainted with the exhibit in the hearings of the Wheeler subcommittee showing that the heads of roads owning one of the largest car lines objected to your association against its continuing to inquire into that subject, and that after that your association dropped the inquiry?
>
> A. (By Mr. PELLEY.) Well, I don't know what you are driving at, but we did not drop the inquiry. *We completed it.*
>
> Q. After you had completed that one year's inquiry, didn't you drop the next year's inquiry on the suggestion of these Western railroad heads who controlled the biggest car line company in the business?
>
> A. No, it would not be dropped because some one or two men might suggest that it be dropped, because matters in our Board are handled by a vote, and each member has one vote. I don't recall fully just what happened there, but *we completed the study—I know that.*
>
> Q. You completed it for one year, didn't you?
>
> A. Well, *we completed the whole thing.*
>
> Q. For one year. Then weren't you going to continue it the next year? Don't you remember that, Mr. Pelley?
>
> A. *If we were going to, we did.*
>
> Q. Weren't you told by the heads of the railroads controlling the biggest car line company that you ought not to do it?
>
> A. Well, I don't know, but if they did tell me that, it would not make any difference.
>
> Q. You think it was continued anyway?
>
> A. *I know it was,* so it would not make any difference.[55]

When it was pointed out to Mr. Pelley that the record of this subcommittee showed that the inquiry was not continued, he suggested that maybe the record was not "up to date," as he distinctly recalled that it was completed.[56] He was then asked why he had not so stated at the subcommittee's hearings, and thereupon Mr. Pelley said that he was quite sure he had not been present at the hearings on that date.[57]

This testimony was subsequently corrected by Mr. Pelley in a letter of October 17, 1938, in which he again verified that the Association had dropped the 1935 study.[58] In his letter, however, Mr. Pelley reiterated the fact that this decision was arrived at by unanimous vote of the executive committee of the Association, thereby deprecating any possibility that Mr. Gray or Mr. Bledsoe had influenced the course of action.[59]

Present at the meeting of the executive committee were the presidents of the Pennsylvania Railroad; the Illinois Central; the Union Pacific; the Chicago, Milwaukee, St. Paul & Pacific; the Baltimore & Ohio; and Mr. Pelley, president of the Association.[60] Mr. Gray, president of the Union Pacific, was the one who originally suggested that the study be dropped;[61] the Illinois Central is controlled by the Union Pacific;[62] the president of the St. Paul had been connected with the Union Pacific for 27 years, leaving his position as vice president of the Union Pacific to become president of the

[54] Ibid., p. 10621.
[55] Ibid., pp. 10633–10634. [Italics supplied.]
[56] Ibid., p. 10634.
[57] Ibid., p. 10635.
[58] Ibid., pp. 10640–10641.
[59] Idem.
[60] Ibid., p. 10641.
[61] Exhibit No. 3366, ibid., p. 10350.
[62] Ibid., p. 9969.

St. Paul;[63] through its large holdings in the eastern trunk lines the Union Pacific had much influence with the Baltimore & Ohio;[64] and the Pennsylvania Railroad is the principal owner of the Fruit Growers Express, one of the private-car companies.[65] While Mr. Pelley testified that he would not be influenced by what Mr. Gray told him, it would appear that all of the other members of the executive committee had connections which would render it difficult for them to decide impartially whether or not to continue the study of private-car rates.

The reaction to the Association's attitude on the part of member roads not in the orbit of the Union Pacific, was expressed by one railroad executive when in discussing the abuses of the private car system he said:

> The Association of American Railroads ought to take hold of these things in a strong and vigorous way. They are not doing it.[66]

In fact the president of the Chicago North Western believed that the Association was doing just the opposite.

> Mr. SARGENT. The present statute provides that the Commission has power to fix the rates for such cars, but they went into this on a certain showing made by the Association of American Railroads and they found that 2 cents a mile was not an unlawful charge.
>
> Mr. LOWENTHAL. Did not the Association do its job properly?
>
> Mr. SARGENT. I do not think they did, myself, to be frank with you. But I made a nuisance of myself while I was on the board of directors, as Mr. Pelley will verify, because I brought the subject up at almost every meeting. * * * If I wanted to use Mr. Joyce's expression, some of the directors have just turned and walked out of the room when I have been talking about this subject, at the time I was a director in the Association of American Railroads.[67]

The Association of American Railroads repeatedly expressed as its aim self-regulatory methods which would prove that the industry could continue under private ownership on a workable basis.[68] But insofar as the question of private cars was concerned it is doubtful whether the railroads had done more than escape from the Scylla of government regulation to the Charybdis of domination by the Union Pacific and its allies.[69]

[63] Hearings, Part XVI, pp. 6825–6826.
[64] A memorandum from the files of the president of the Delaware & Hudson Railroad states:

> "The great difficulty which we have encountered in the past was largely due to the opposition of Mr. Gray and the influence which his large holdings in the trunk lines gave him, with Mr. Williamson of the New York Central and Mr. Willard of the B. & O. When Mr. Harriman was in charge of the Union Pacific he immediately recognized that the prosperity of the Union Pacific and Southern Pacific lay largely in the growing movement of perishable freight traffic from the Pacific coast to the East. This tonnage is carried in the cars of the Fruit Express. To obtain excessive divisions for the Union Pacific and the Pacific Fruit Express line he acquired large interests in the Eastern Trunk Lines with the result that, whereas he was justly entitled to only 50 percent of the rate, he obtained directly and indirectly 75 percent of the rate, which gave additional earnings to the Union Pacific alone last year of $17,000,000 net. If the Fruit Express had the just proportions that it would ultimately have and will have, it will mean transferring $17,000,000 of net earnings from the Union Pacific and giving it to the roads in the East. Here is the "colored man in the wood pile" and the hidden basis of the opposition to a railroad adjustment. * * *" (Exhibit No. 3375, Hearings, Part XXIII, p. 10360.)

> In this connection it should be noted that the only member of the executive committee of the Association not present at the meeting was Mr. Williamson of the New York Central. (Hearings, Part XXIII, p. 10641.)

[65] Ibid., p. 9989. It should also be noted that the Union Pacific with 115,200 shares is the second largest stockholder of the Pennsylvania Railroad.
[66] Ibid., p. 9988.
[67] Ibid., pp. 9988–9989.
[68] Exhibits Nos. 3421, 3427, 3444, 3445, ibid., pp. 10412–10413, 10418, 10450–10454.
[69] In order to determine the fairness of private-car rates the Interstate Commerce Commission requested Congress for "authority over the accounts of the car-line companies and over their contractual relations with the railroads." (I. C. C. Ex Parte No. 137. Decided July 31, 1941.) This power was granted the I. C. C. under the Transportation Act of 1940.

3. *Pullman contracts.*—A problem similar to that of the private cars is that of Pullman cars. The Pullman Co. through the monopoly of the sleeping-car business is able to dictate the terms of the contracts it makes with individual railroads.[70] As one railroad president put it—"we have either got to use Pullman cars or none."[71] This executive believed that hearings should be held to develop all the facts and then to determine whether or not the Pullman Co. contracts were fair.[72] The Association of American Railroads with its large membership would appear to be admirably qualified to represent the railroads in reaching some agreement with the Pullman Co. But the head of one of the member roads testified that here again the A. A. R. had no interest in the matter.

> * * * I think no injustice would be done if these contracts had to be submitted to the Interstate Commerce Commission before they were executed. I think the Association of American Railroads ought to take hold of that. But the Pullman Co. is a member of that Association. And there we are again.[73]

Another factor in the Pullman monopoly is the relationship between railroad bankers and the Pullman Co. J. P. Morgan & Co. and the First National Bank have acted as bankers for at least 17 railroad systems,[74] and at the same time have had six representatives on the board of Pullman, Inc.[75] Mr. Pelley denied that such interlocking relationships, at least in the case of the New Haven, made it difficult for roads within the sphere of the Morgan-First National group to protest the terms of Pullman contracts.

In hearings before the emergency board appointed to investigate a proposed wage reduction for railroad employees, the president of the A. A. R. testified as follows:

> Q. (By Mr. LOWENTHAL.) Do you know who the bankers of the New Haven were at any time during its history?
>
> A. (By Mr. PELLEY.) Only from the records and general information, J. P. Morgan & Company certainly were the bankers.
>
> Q. And do you know that J. P. Morgan & Company and their financial associates are on the Board of the Pullman Company?
>
> A. I think I know that one of them is on the Board. * * * While I was on the New Haven Railroad, the Pullman Company contract expired and at no time did Mr. George Whitney or anybody in J. P. Morgan & Company say anything to me about the renewal of the Pullman Company contract. * * * We realized that we had a very favorable contract with the Pullman Company that had been running over a period of years, and I felt myself that we probably would not be able to get one quite so favorable to us * * *.
>
> Q You thought that you couldn't do better if the railroads pooled their own facilities?
>
> A Right, I don't think we could.
>
> Q Do you know how much profit the Pullman Company made on your contract?
>
> A No, I don't.[76]

The A. A. R., whose president was astounded at the suggestion "that there is money to be saved by doing something about the Pullman Company",[77] never took any action on the question of Pullman contracts. On July 12, 1940, however, the United States Government brought suit against the Pullman Co. for violation of the antitrust laws, charging that the Pullman Co., through its monopoly of operating and manufacturing sleeping-cars, has charged railroads prices that are "artificial, noncompetitive, and unreasonably high."[78]

4. *Form of organization of the Association.*—The Association was further criticized by its members for its lack of democratic procedure. Apparently decisions of the Association were made by a small group of roads rather than by the industry as a whole. In a memorandum written in October 1937, three years after the A. A. R. was founded, one railroad executive said:

> I told Mr. Pelley in our telephone conversation, which he refers to in his letter of October 12, that executives of all railroads before they are called in to approve a plan ought to have a copy of what they are to pass on at least two or three days in advance of the meeting, instead of waiting until they get into a meeting and then steam rolling the thing through without proper discussion. He intimated that he would do this and while I have heard nothing further from him, I notice in the press that they have a program lined up to apply for new rates. I think we who are interested should have sufficient time to go over the matter with our operating and traffic people, to see if there are any suggestions we can add which will facilitate the matter. As it is, we are usually called in to approve something that the Directors have decided upon without proper debate or recommendations from the individual lines.[79]

Another member of the Association described its procedure as follows:

> * * * I understand there is to be a meeting in Chicago, and the directors are going to meet about an hour before the rest of us are called in to consider whatever they passed on. An hour is a pretty short time; and I do not know what they are going to pass on. It seems to me that we ought to be taken into their confidence in these very important matters as long in advance as possible. * * * [80]

In general the smaller railroads felt that they were ignored by the larger ones which dominated the Association.[81] For instance at one meeting of the A. A. R. a representative of a small road asked a question concerning the attitude of the Association toward a problem which many of the carriers considered highly important. The answer to the question, according to one of the members, was that Mr. Clement, vice president of the Pennsylvania Railroad, "made a motion to adjourn, and Mr. Pelley was gone from the platform before anybody knew what was going on."[82]

These criticisms are particularly significant when it is recalled that at the time of the organization of the Association it was pointed out that among the faults of past associations which should be avoided were insufficient discussion of problems, disposing of subjects in "thirty minutes or an hour" and making decisions on the basis of individual interests rather than the welfare of the industry as a whole.[83]

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[70] Ibid., p. 9991.
[71] Ibid., p. 9992.
[72] Idem.
[73] Ibid., p. 9993.
[74] Including the following railroads: New York Central; Delaware, Lackawanna & Western; Chesapeake & Ohio; Missouri Pacific; Erie; New York, Chicago & St. Louis; Pere Marquette; Chicago & Eastern Illinois; Wheeling & Lake Erie; Denver & Rio Grande Western; Great Northern; Northern Pacific; Chicago, Burlington & Quincy; Spokane, Portland & Seattle; Gulf, Mobile & Northern; Atchison, Topeka & Santa Fe; Western Pacific. "The Structure of the American Economy", Part I, published by the National Resources Committee, June 1939, p. 310.
[75] Ibid., p. 314. Pullman, Inc. is a holding company of which Pullman Co. is a wholly owned subsidiary.
[76] Hearings, Part XXIII, p. 10631.

[77] Idem.
[78] In the District Court of the United States for the Eastern District of Pennsylvania, June Term, 1940, Civil Action No. 994, pp. 75–76.
[79] Exhibit No. 3354, Hearings, Part XXIII, p. 10222.
[80] Ibid. pp. 9981–9982.
[81] Ibid., p. 9975.
[82] Exhibit No. 3351, ibid., p. 10219.
[83] Exhibit No. 3436, ibid., pp. 10433–10434.

COORDINATION

Coordinator Eastman's report calling for an inclusive, central railroad organization also recommended the continuance of an officer of the Government with powers similar to those of the Coordinator.[84] His thought was that this officer representing the Government and an organization representing the railroads could cooperate to improve the railroad situation.[85]

The committee of nine directors which took the leading part in forming the A. A. R. was in accord with this suggestion of the Coordinator. Mr. Fairman Dick, one of the committee, testified on this subject.

The CHAIRMAN. These members of your group were anxious that such a railroad organization should cooperate with the Coordinator in accordance with his report?

Mr. DICK. That is correct.

* * * * * * *

The CHAIRMAN. Was not one of the reasons why you organized it to work with the Federal Coordinator of Transportation?

Mr. DICK. Yes. There was a strong sentiment in the directors' group that every effort should be made to cooperate with the Coordinator.[86]

Similarly in correspondence about the organization of the A. A. R. the directors' committee expressed approval of this idea. In January 1934, one member wrote:

At whatever effort and cost, they should try to go along with the Coordinator all the way.[87]

And another wrote:

That the railroad executives signify their approval of *all of the recommendations* contained in Eastman's first report of January 22.[88]

However, when the railroad executives themselves came to consider the question they were reluctant to go as far as the directors. General Atterbury, president of the Pennsylvania, was particularly opposed to endorsing all the proposals made by the Coordinator. A letter from the files of the Committee of Railroad Directors states:

He [Atterbury] still had doubt lest the executives should, by paying too much of a tribute to the coordinator, build up his authority too much.[89]

And in June 1934 a meeting held in Chicago to discuss the formation of the A. A. R. was described by one of the directors as follows:

At the meeting yesterday the dissenters were Atterbury, Cole [president of the Louisville & Nashville], Bernet [president of the Chesapeake & Ohio], and Baldwin [president of the Missouri Pacific]. After discussion at length these gentlemen strongly opposed approval of the Eastman propositions because they felt that by so doing we were committing ourselves to a permanent office of Coordinator * * *.[90]

By the time the A. A. R. was founded in October 1934 a wholly different concept had appeared—that the railroads instead of cooperating with the Coordinator were to form an organization to take

[84] Ibid., p. 10053.
[85] Idem.
[86] Ibid., p. 10056.
[87] Exhibit No. 3421, ibid., p. 10412.
[88] Exhibit No. 3425, ibid., p. 10416. [Italics supplied.]
[89] Exhibit No. 3426, ibid., p. 10417.
[90] Exhibit No. 3430, ibid., p. 10423.

his place. A memorandum prepared by Judge Fletcher outlining the history of the A. A. R. contains the following statement:

It was realized that the Association could best serve the needs of the industry by doing the work which the law now imposes upon the Coordinator and the Coordinating Committees created by the Emergency Transportation Act, 1933.[91]

The Emergency Transportation Act expired in June 1935.[92] In May 1935 the Association of American Railroads set forth its policy in a memorandum as follows:

It is thought wise that the President of the Association should not make public statements in opposition to the continuance of the office of Coordinator at this time; that if approached by the Press for statement of his position reply should be that the railroads' managements and the various groups representing stock and bond interests feel that the Association which was not in existence at the time the Coordinator Act was passed is now in a position to handle directly the functions it was expected the Coordinator might perform with resulting economies from coordination, consolidation, etc.[93]

The reason for the opposition to the Coordinator was set forth in a letter written by Mr. Clement, of the Pennsylvania Railroad, to the directors' committee.

As far as I can make out, they [Committee of Nine] are, on certain fallacious premises, constructing reasons for the continuation of the Coordinator. The situation, unfortunately, is getting itself into the question of "Shall the Coordinator's organization be continued, with gradually expanding authority, or shall the Association of American Railroads be continued, with ever expanding authority?" The two are incompatible with each other—the one being Government Operation by indirection, while the other is gradually increased centralization of authority of the railroads in a group of their own making, that should be sufficiently strong to solve their problems.

* * * * * * *

It seems only fair to say that the Board of Directors of the Association of American Railroads, with full understanding of the possible criticisms and the complications connected therewith, voted unanimously to recommend the non-extension of the Coordinator Act, * * *.[94]

At the subcommittee's hearings the officers of the A. A. R. were frank to admit that the A. A. R., in their opinion, made the position of coordinator unnecessary.

Mr. BROWN. Mr. Pelley, was not one of the purposes of the Association of American Railroads to handle railroad problems within the industry?

Mr. PELLEY. That was the sole purpose.

Mr. BROWN. As I recall the publicity at the time, was it not stated that the railroads themselves in the Association could do a better job with many problems that the Coordinator was dealing with?

Mr. PELLEY. Well, I do not know that it was stated it could do a better job, but we could do it perhaps in a better way, generally speaking.[95]

Judge Fletcher went even farther in his testimony.

The CHAIRMAN. Now, Judge Fletcher, as a matter of fact your organization, the A. A. R., opposed the continuance of the Coordinator, did you not?

Mr. FLETCHER. Yes, sir.

The CHAIRMAN. And the reason you opposed it was because of the fact that you felt that your Association should do that work itself?

[91] Exhibit No. 3444, ibid., p. 10452.
[92] Ibid., p. 10072.
[93] Exhibit No. 3446, ibid., p. 10454.
[94] Exhibit No. 3445, ibid., pp. 10453–10454.
[95] Ibid., p. 9978.

Mr. FLETCHER. That if it should be done at all, it should be done by our Association.

The CHAIRMAN. And one of the reasons expressed was, that it should be done by your organization rather than by the Coordinator?

Mr. FLETCHER. That whatever was necessary and helpful should be done by the Association.[96]

The hope of the Coordinator had been that his office in cooperation with the Association could bring about certain economies through the coordination of railroad facilities. If the Association was qualified to take over the Coordinator's work, what did it do in the way of coordination? A report dated October 16, 1937, summarized the accomplishments of the first 3 years.[97] During this period 556 coordinating projects had been studied of which 532 had been dropped for various considerations. The remaining 24 were carried through but these were small projects which only saved the railroads $294,524 a year.[98]

UNIFICATION

In 1934 Mr. R. H. Aishton, chairman of the executive committee of the Association of Railway Executives, a predecessor of the Association of American Railroads, wrote to the president of the Pennsylvania Railroad regarding the vast maze of railroad associations,

* * * There is now a lot of excess baggage in existence in many of these independent organizations, tending only to duplication of work and paucity of results.[99]

The formation of the Association of American Railroads was intended to eliminate these superfluous organizations and create one strong group. As Mr. John J. Pelley, president of the Association, testified:

The purpose of the Association was to bring together the other associations that were in existence, and to strengthen the one organization to handle all matters of common concern for the railroads.[1]

Mr. R. V. Fletcher, vice president and general counsel to the Association, also believed that railroad problems could be better handled by having one organization.

* * * It seemed to me that we would have better unity, more uniformity of policy and perhaps an opportunity for some slight economies in the matter of actual outgo if all these different organizations could be put into one.[2]

Many of the preliminary plans for the A. A. R. stressed this objective. One such plan contained this statement:

The purpose of this plan is to consolidate into one organization the beneficial activities of *all* present associations dealing, *directly or indirectly*, in subjects connected with the American railways.[3]

Another plan said:

That all activities, of any kind or branch whatsoever connected with railroad work, are going to have to function under this organization.[4]

[96] Ibid, p. 10072.
[97] Exhibit No. 3447, ibid., p. 10455.
[98] Ibid., p. 10074.
[99] Exhibit No. 3438, ibid., p. 10437.
[1] Ibid., p. 10127.
[2] Ibid., p. 10060.
[3] Exhibit No. 3435, ibid., p. 10429. [Italics supplied.]
[4] Exhibit No. 3436, ibid., p. 10434.

However, when the actual plan of organization was drawn up the idea of *consolidating* the various organizations was abandoned, and instead the plan merely said that the purpose of the Association was:

To *coordinate* the activities of the several associations dealing, directly or indirectly, with subjects connected with the American railroads.[5]

As a result the creation of the Association of American Railroads failed to alter materially the unsatisfactory set-up of railroad organizations or to bring about that "more perfect union" which was ascribed as the purpose of the A. A. R. Of the over 130 groups existing at the time the A. A. R. was formed, only eight were consolidated into the A. A. R. The rest continued as independent organizations.[6]

Judge Fletcher originally testified that he thought "there would be a great deal of benefit in having all these various organizations put into one."[7] He later said this did not apply to any except national groups.

The CHAIRMAN. The executives originally planned to consolidate these numerous associations with the A. R. E. and A. R. A. and to dissolve those associations found to be unnecessary?

Mr. FLETCHER. Well, that was the desire, hope, and sentiment of the executives, but I would not be able to say that that was the consensus of opinion of all railroad officers.[8]

* * * * * * *

The CHAIRMAN. It was realized that the existent set-up of numerous associations to deal with railroad problems, created in large measure duplication of work, and resulted in inefficiency?

Mr. FLETCHER. Well, I am quite certain I agree with that statement so far as national associations are concerned. * * *

The CHAIRMAN. Mr. Aishton, chairman of the executive committee of the A. R. E., stressed the need of merging the numerous railroad associations?

Mr. FLETCHER. I think so.

The CHAIRMAN. Mr. Aishton believed that this would eliminate duplication of functions and improve the organization of the railroad industry?

Mr. FLETCHER. I think so.[9]

* * * * * * *

The CHAIRMAN. The plan of organization of the Association of American Railroads as finally adopted eliminated specific reference to the numerous railroad associations and their consolidation under the various departments of the A. A. R.?

Mr. FLETCHER. They eliminated, generally speaking, the regional associations.[10]

* * * * * * *

The CHAIRMAN. The system of numerous independent associations dealing with various phases of railroad problems, involving the duplication of functions and resulting in inefficiency, still exists?

Mr. FLETCHER. Well, I would not want to agree to the implications in all that question. But the regional associations do exist. I do not think they are inefficient.

The CHAIRMAN. How is that?

Mr. FLETCHER. I do not think they are inefficient, or unnecessary, or duplicative, if I may coin that word.

The CHAIRMAN. Do you think it necessary to have these various other organizations?

[5] Ibid., p. 10067. [Italics supplied.]
[6] Ibid., pp. 10067–10068.
[7] Ibid., p. 10060.
[8] Ibid., p. 10064.
[9] Ibid., p. 10065.
[10] Ibid., p. 10067.

Mr. FLETCHER. I would not undertake to say that every one of them is necessary, but I do not believe it would be a good idea to try to concentrate in a national association all these various regional and local associations that serve special purposes peculiar to their own territories.[11]

In view of the fact that only eight of the one hundred and thirty odd associations were unified under the A. A. R. it is hardly surprising that instead of the economies that Judge Fletcher said he hoped would be effected by doing away with the various organizations,[12] the yearly expense of maintaining the associations increased. From 1933 to 1936 the annual cost to the railroads increased almost $1,000,000.[13] In 1933 the railroads spent $6,235,348.94 on their associations and in 1936 they spent $7,117,975.35.[14]

The greatest portion of this sum went to the Association of American Railroads which spent $3,000,000 a year, one million on advertising alone.[15] The value of these expenditures may be questioned when it is seen that in the fields of self-regulation, coordination, and unification the Association has fallen far short of its original aims. At the subcommittee's hearings the chairman reached the following conclusion:

* * * The railroads are spending $3,000,000 a year through the Association of American Railroads * * *. The only thing I am wondering is, how railroad executives can be such a bunch of suckers as to put up the money they have put up, because I must say that there has been nothing done of a very constructive nature so far to bring them out of their muddle. * * *[16]

TRANSPORTATION ASSOCIATION OF AMERICA

At about the same time that the railroads were organizing the Association of American Railroads (A. A. R.) to deal exclusively with railroad problems, the Transportation Association of America (T. A. A.) was formed to deal with the subject of transportation in general.[17] The Shippers and Manufacturers Transportation Association dissolved and went into the T. A. A.[18] The A. A. R. approved and lent its support to the organization.[19] In addition, other business interests cooperated with these groups[20] in forming the Transportation Association of America which was incorporated in April 1935,[21] as a "nonprofit organization created for research and general public education in the field of transportation."[22]

PURPOSE OF THE T. A. A.

The wide variety of interests behind the Association would seem to assure a broad basic approach to the problems of transportation. This assumption is strengthened by statements of the organization

[11] Ibid., pp. 10067–10068.
[12] Ibid., p. 10060.
[13] Exhibit No. 3440, ibid., p. 10441.
[14] Ibid., p. 10069.
[15] Ibid., p. 10033. Series of full page advertisements sponsored by the Association of American Railroads opposing government ownership, urging lower taxes, and suggesting more Federal regulation of competitive forms of transportation, regularly appear in mass circulation American weeklies and monthlies.
[16] Hearings, Part XXIII, p. 10045.
[17] See p. 21, supra, for a discussion of preliminary plans for organizing a national transportation association.
[18] Exhibit No. 3616, Hearings, Part XXIII, pp. 10609–10610.
[19] Exhibit No. 3596, ibid., pp. 10586–10587.
[20] Exhibits Nos. 3594, 3609, ibid, pp. 10584–10585, 10595–10596.
[21] Exhibit No. 3592, ibid., p. 10581.
[22] Exhibit No. 3593, ibid., p. 10584.

which indicated that it was equally concerned with all form of transportation and their relationship to the public interest. According to its certificate of incorporation the purpose of this organization was—

To foster and stimulate the creation and operation of an efficient, economical, and prosperous national system for the commercial transportation and the marketing and distribution of goods, composed of many separate agencies and instrumentalities, properly and fairly coordinated and interrelated to produce the greatest efficiency at the lowest ultimate cost, yet so balanced as to preserve the necessary degree of constructive competition, and to provide opportunity, initiative, ownership, and operation of all elements of the same, subject only to such degree of restraint, stimulus, and regulation by government as may be necessary to insure its development, operation, and preservation in the public interest.[23]

The printed pamphlet put out by the A. A. R. on the subject of the Transportation Association of America concluded as follows:

The relationship of the public to the transport problem has heretofore been expressed only in terms of individual interests. This has been true in the matter of freight rates, service, public expenditures, labor relations, legislation, and innumerable other considerations. The people of this country have never attempted to project a "long time" program, strictly economic in its conception, and wholly developed from a standpoint of the public interest. In the task of giving unbiased economic consideration to this vast problem and in developing a sound public policy for the future of transportation in all of its ramifications, the Transportation Association of America presents a common-sense approach to one of the Nation's greatest problems.[24]

Such were the Transportation Association's publicly stated aims. But in private correspondence the founders expressed themselves somewhat differently. The Shippers and Manufacturers Transportation Association made the following statement to its membership:

The Transportation Association of America was organized early in April 1935, by a group of representative business men throughout the Country, including representatives of large insurance companies, investors, railway equipment interests, agriculture, flour mill interests, and *others interested primarily in opposition to Government ownership of railroads.*[25]

The Association of American Railroads in a letter to the president of one of its member roads said:

Organized as it is, with a cross section of the major and representative business interests of the country, I believe *this Association can serve a very useful purpose, particularly so far as the railroads are concerned,* in combating any movements having for their objective government ownership of railroads, * * *.[26]

And in a letter to the president of the Baltimore & Ohio Railroad, the A. A. R. said:

As a matter of information, one of the main purposes of the Transportation Association of America is to develop and build up sentiment in this country against any form of government ownership of railroads, or other transportation agency, the unwarranted expenditure of funds by the government for the development of unnecessary waterway transportation, and in various other directions.[27]

These are but examples of many statements[28] which suggest that the real object of the Transportation Association was to protect the

[23] Exhibit No. 3592, ibid., p. 10581.
[24] Exhibit No. 3597, ibid., p. 10587.
[25] Exhibit No. 3616, ibid., p. 10609. [Italics supplied.]
[26] Exhibit No. 3599, ibid., p. 10588. [Italics supplied.]
[27] Exhibit No. 3597, ibid., p. 10587.
[28] See also Exhibits Nos. 3625, 3595, 3617, ibid., pp. 10615–10619, 10585–10586, 10611–10612.

railroads against the danger of government ownership and the competition of other forms of transportation. In fact, one railroad president could not understand why it was necessary for the Transportation Association to exist alongside the A. A. R. since it appeared to be the same organization under another name.

> Frankly, I cannot see but what the purposes and functions of the Transportation Association of America are direct duplications of most of the branches of work now covered by the Association of American Railroads.[29]

The reason for organizing a second association becomes apparent on a further examination of the structure, finances, and work of the Transportation Association.

ORGANIZATION OF THE T. A. A.

During the weeks of preliminary organization Mr. Donald D. Conn, executive vice president of the Association, was in Chicago interviewing prominent businessmen. Among others, he saw Mr. Sewall Avery, and in a letter to the A. A. R. described his interview with him.

> In my talks with Avery (Chairman of Montgomery Ward) he criticized the railroads and particularly the A. A. R. for, as he says "doing nothing". * * * He thought the A. A. R. should come out openly with the Transportation Association program. I explained that your position would be stronger if the effort was a joint one from the beginning—including shipper, insurance company, railroads and the public generally. * * *[30]

Far from coming out "openly," the A. A. R. made every effort to conceal its role in the Transportation Association. The executive committee of the Association was elected on May 23, 1935.[31] Shortly thereafter the chairman of this committee wrote to Mr. Pelley, president of the A. A. R.:

> The responsibility for the conduct of the affairs of the Association will largely rest upon the Executive Committee and it is our purpose to start off right and try not to make any mistakes. We feel *it is most essential that you and Judge Fletcher attend the first Meeting of this Committee, which is tentatively set for June 27, 1935, in Saint Louis. If you find you cannot attend on this date, I am wondering if you could designate a date shortly thereafter that will conveniently fit your plans.*[32]

Upon receipt of this invitation Mr. Fletcher wrote to Mr. Pelley:

> Before I reply to Mr. Davis, I should like to know what you think about our going to St. Louis. *My own judgment is that we should not go.* It seems to me that the railroads ought not to be too active in the preliminary organization of the Transportation Association.[33]

The policy of keeping the railroads in the backgrounnd was carefully followed in selecting the board of directors and in soliciting members. In July Mr. Conn wrote: "All invitations are going forward to industry and the railroads in a relative proportion so that as we build our list of membership, interests other than the railroads will predominate." [34] Only four of the 48 directors were railroad men.[35] However, judging from a letter Mr. Conn wrote to the chairman of the Western Association of Railway Executives, the other 44 directors were chosen according to their "railroad attitude."

> I hope to complete this Board by the first of September, but we are having difficulty in securing the right class of agricultural representation. Many men are nominated but, upon investigation, we find sufficient objection, *particularly as to their railroad attitude*, to warrant very careful consideration.[36]

FINANCES OF THE T. A. A.

The financing of the Transportation Association was also carried out in such a way as to minimize the railroad contributions. At the time of organization the A. A. R. gave the Association $5,000 for preliminary expenses.[37] Subsequently the A. A. R. decided against any further contributions for the reason that—

> * * * If there was any indication of any large contribution being made by this Association to the Transportation Association, it would immediately carry the impression to other groups interested that the Association was dominated by the railroads and would immediately lose its beneficial effects.[38]

Instead the A. A. R. urged individual roads and their executives to join. On June 1, 1935, Mr. Pelley sent the following communication to A. A. R. members:

> 1. The strength of the Transportation Association will depend upon the extent of its membership and individual railroads and others will be solicited direct, rather than accepting membership from groups or associations.
> 2. Railroads will be asked to become sustaining members on the basis of a minimum annual fee of $100, ranging up to a maximum fee of $1,000, dependent entirely upon the individual road's relative size and position.
> 3. In addition to railroad membership, individual railroad officers and employes will be solicited for membership.
> 4. Support is asked from the Presidents of Class I railroads in the way of personal subscriptions for minimum sustaining memberships of $50 per annum.
> 5. The Transportation Association does not ask railroad management to solicit the membership of their officers and employes. That will be dealt with directly by the Association in its solicitation. All the Association asks in this direction is that the railroad officers have an understanding of the objects of the movement, so they may, upon request, acquaint the shipping public with information desired.
> * * * * * * *
> There appears to be a real need for an organization of this kind and its work, if properly carried on, should go far in helping to solve the transportation problem. It would seem desirable, therefore, that the individual railroads lend their aid and assistance in what we believe is a worthwhile movement and your cooperation will be appreciated.[39]

This letter apparently had little effect as the T. A. A. in soliciting employe memberships met with considerable "passive resistance" [40] on the part of certain roads. Finally on November 4, 1935, Mr. Conn wrote to Mr. Pelley asking the A. A. R. to make another plea to its member roads.[41] The extent to which individual employes did contribute is suggested by letters from the files of the Transportation Association which reveal that 56 applications were received from the staff of the Erie Railroad,[42] and 57 from the Texas and Pacific Railway Co.[43]

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[29] Exhibit No. 3598, ibid., p. 10588.
[30] Exhibit No. 3604, ibid., p. 10592.
[31] Exhibit No. 3606, ibid., p. 10593.
[32] Exhibit No. 3606, ibid., p. 10593.
[33] Exhibit No. 3607, ibid., p. 10593.
[34] Exhibit No. 3603, ibid., p. 10590.
[35] Ibid., p. 10209.
[36] Exhibit No. 3603, ibid., p. 10590. [Italics supplied.]
[37] Exhibit No. 3622, ibid., p. 10615.
[38] Exhibit No. 3610, ibid., p. 10596.
[39] Exhibit No. 3596, ibid., pp. 10586–10587.
[40] Exhibit No. 3600, ibid., p. 10589.
[41] Idem.
[42] Exhibit No. 3601, ibid., p. 10589.
[43] Exhibit No. 3602, ibid., pp. 10589–10590.

In addition to the A. A. R. contribution and the membership dues of individual railroads, the Transportation Association asked for further help from the carriers in meeting the organization expenses. The reason for making two separate requests was explained by Mr. Conn in a letter to an official of the Lake Superior & Ishpeming Railroad.

In the case where we are asking prosperous lines for only $1,000, we are also requesting that these railroads donate as generously as their condition permits to our first year's "Organization Fund" and to grant us such other assistance as will help to properly initiate this movement throughout the different parts of the country. *Our purpose in placing the maximum membership fee at a low figure was to restrict the total railroad contributions to between five and ten percent of the budget requirements. The reason therefor is obvious.*[44]

At the subcommittee's hearings it was testified that at the time 28 percent of the revenues of the Transportation Association came from the railroads.[45] But there was no indication as to whether this figure included all railroad contributions or only membership fees.

Although the A. A. R. gave $5,000 for the specific purpose of underwriting the organization costs of the T. A. A. and individual railroads were asked to contribute *in addition* to their membership dues, the annual report of the T. A. A. in November 1936 stated:

The incorporators of the Association purposely refrained from accepting initial underwriting or financial sponsorship from any particular group. The operations of the Association have been defrayed *only* from membership dues.[46]

PUBLICATIONS OF THE T. A. A.

The A. A. R. not only helped to organize and finance the Transportation Association, it played an active part in the Association's program of "education" and research.[47] Publications of the T. A. A. were submitted to the A. A. R. for criticism and changes, while the A. A. R. submitted material to the T. A. A. for publication.[48]

Material put out by the Transportation Association was distributed free to its members, chambers of commerce, various trade associations, educational institutions and newspapers.[49] The role of the railroads in this distribution was pointed out in a letter from the president of the Association to the president of the Chesapeake & Ohio Railroad.

Up to now we have been looking to the railroads to disseminate our literature, widely stressing the point that it comes not from any selfish railroad interest but from the public interest about it.

Because of our rather meager financial resources we have been asking railroads to pay 5¢ per copy for copies additional to the few we send them out of our original supply. * * *[50]

The advantages of an ostensibly independent organization were quickly recognized by the railroads. Within a few days after the Transportation Association was incorporated, one of the directors of the Missouri Pacific Railroad wrote to the Western Railways Committee as follows:

[44] Exhibit No. 3605, ibid., p. 10592. [Italics supplied.]
[45] Ibid., p. 10209
[46] Exhibit No. 3625, ibid., p. 10615 at p. 10619. It is interesting to note that a copy of this annual report from the files of the C. & O. bore a pencil notation "A. A. R." next to this paragraph.
[47] Exhibits Nos. 3627, 3625, ibid., pp. 10620, 10615–10619.
[48] Exhibits Nos. 3595, 3624, ibid., pp. 10585–10586, 10615.
[49] Exhibits Nos. 3625, 3626, ibid., pp. 10618, 10619.
[50] Exhibit No. 3626, ibid., p. 10619.

* * * The new Transportation Institute [i. e. Association] should start out as soon as possible with a series of four or five strong anti-government ownership articles to be broadcast to every publication * * * that is receiving the joint advertising schedules of Western Railroads, without any reference to the joint advertising, of course.

If this is done by some *neutral outside agency*, I am sure that many of the newspapers will print such articles.

Among other things, it is my thought that one of the first articles should * * * mention incidentally that immediately following government ownership all advertising and publicity of the railroads unquestionably would be suppressed and that the railroads would fall into a class with the post-office, so far as advertising is concerned.

* * * * * * *

We know from our own experience that it is difficult for an individual railroad to get newspapers to do anything about this, and in many instances, such as our own case, if the effort could be tied to the railroad sponsoring the idea it might prove embarrassing. Also, *some neutral agency such as the Transportation Institute* could be very specific, where a railroad would probably find it necessary and advisable to confine the work to "glittering generalities."[51]

Another form of meeting the problem was suggested by the Association of American Railroads which submitted an article to the Transportation Association with the following letter:

DEAR MR. CONN: The attached so clearly expresses an important phase of Government regulation versus Government ownership that I feel you might find use for the article.

In order that there may be no criticism, you should know that Mr. Evans is a Pennsylvania Railroad employee on leave of absence and is now with the Association of American Railroads.

If articles of this nature, signed by some one not associated with the railroads, would be of greater value future articles could be printed under the name of some impartial writer.[52]

The Association of American Railroads has its own program of education and research; it spends large sums of money every year to advertise facts as the railroads see them. Nevertheless the carriers deemed it necessary to set up another organization to carry on the same type of work. There can be no other explanation for this apparent duplication of effort than that in the Transportation Association the railroads saw an opportunity to offer to the public the same material marked "railroad point of view" by the A. A. R. but by the T. A. A. stamped "neutral," "independent," "unbiased."

LEGISLATIVE ACTIVITIES OF RAILROAD ASSOCIATIONS

Legislation has long been considered one of the major spheres of activity for railroad organizations,[53] and according to Mr. Pelley is now one of the primary functions of the Association of American Railroads.

The CHAIRMAN. In addition to operation and traffic you also were to look after legislative matters, were you not?

Mr. PELLEY. Yes. That is the function of the Association.[54]

DEFINITION OF LOBBYING

Railroads' objectives in this field were described by Judge Fletcher in 1932 when he said that the general legislative committee of the

[51] Exhibit No. 3608, ibid., p. 10594. [Italics supplied.] See also Exhibit No. 3621, ibid., p. 10614.
[52] Exhibit No. 3624, ibid., p. 10615.
[53] Ibid., p. 10074.
[54] Ibid., p. 10128.

Association of Railway Executives was "charged with the duty of assembling and promulgating information relative to legislation affecting railroads, and with the further duty of organizing the States for offense and defense on all matters of legislation, State and Federal, affecting railroads." [55]

At the subcommittee's hearings Mr. Fletcher agreed that his statement was a fair definition of lobbying and developed further his views on the subject.

> The CHAIRMAN. That is a mighty good definition of lobbying, is it not?
>
> Mr. FLETCHER. If that is your definition, Mr. Chairman, of lobbying, I will go along with you.
>
> * * * * * * *
>
> The CHAIRMAN. * * * Whenever people present facts openly before committees of Congress, that is a perfectly legitimate form of representation; not only when they openly present matters before legislative committees but likewise when they present them to executive bodies.
>
> Mr. FLETCHER. The only thing I would ask you to go further with me on, and it may be you cannot go that far with me, is to say that it is perfectly legitimate for any industry to endeavor to get their point of view to the people of the country.
>
> The CHAIRMAN. I think that is entirely proper. I think there is no question about that.
>
> Mr. FLETCHER. All right.
>
> The CHAIRMAN. Provided they do it in an honest way.
>
> Mr. FLETCHER. In an open and above-board way.
>
> The CHAIRMAN. In an open, honest, and frank way. But it should not be attempted under the subterfuge that it is being done for someone else.
>
> Mr. FLETCHER. I agree with you 100 percent on any question of subterfuge.[56]

ORGANIZATION

The present legislative activities of the Association of American Railroads are largely based on the system created by the Association of Railway Executives. Mr. Fletcher who was chairman of the legislative committee of the A. R. E. was thereafter given charge of legislative work for the A. A. R.[57]

In 1931 the A. R. E. decided to set up committees to introduce and work for legislation favorable to the railroads, and against bills inimical to the railroads, and to try and standardize laws in the various States dealing with transportation.[58] In addition, Mr. Fletcher conceived their purpose to be "educational."

> There is a more important work, however, for the organization. This important work has to do with educating and creating public sentiment in favor of the railroads upon all questions which vitally affect them. It is hoped that the organization can disseminate information with reference to bills pending in Congress and propositions put forward both by the protagonists and antagonists of the railroads, together with leaflets or small pamphlets stating the arguments pro and con in order that all the local attorneys in the country, as well as the State's Attorneys, may understand just what propositions are under discussion at Washington and may be able to consider these intelligently in discussing the matter with influential citizens before luncheon clubs, and particularly with members of Congress.[59]

The A. R. E. first set up an office in Washington to deal with Federal legislation.[60] In January 1932 it expanded its activities to include

[55] Exhibit No. 3448, ibid., p. 10455.
[56] Ibid., pp. 10075–10076.
[57] Ibid., pp. 10075, 10091.
[58] Exhibit No. 3448, ibid., pp. 10455–10458.
[59] Exhibit No. 3448, ibid., p. 10455 at p. 10457.
[60] Exhibit No. 3448, ibid., p. 10455 at p. 10456.

state legislation.[61] Each State was assigned to a railroad counsel in that area who then formed a State wide system of committees.[62] These committees were not intended to concern themselves with national matters unless called on by the Washington office,[63] but the manner in which they could be used is indicated in the following letter of May 15, 1934, written by Mr. Fletcher to one of the railroad counsel.

> I know you are aware of the danger which confronts the railroads by reason of the desperate effort which is being made by union labor to pass the Six-Hour-Day Bill. * * * I have quite an active committee working here and I have pulled every string which is accessible. I have some hope now that the bill will be allowed to remain in the Committee on Rules and will not be brought before the House for an actual vote at this session. However, in view of the tremendous importance of the matter we cannot afford to take any chances. I am, therefore, asking you to do this for me:
>
> I should like to have your associates in the State of South Dakota go over the situation in their own mind and select a list of men who would be particularly influential with members of Congress and with Senators and who could come to Washington if the emergency arises. I should like for these men to be made familiar with the provisions of the bill and to our objections thereto so that they can discuss the matter intelligently with the members of Congress. In my opinion, it would be a mistake to bring to Washington anybody except persons who are quite well acquainted with the members of Congress and who would not only have influence with such members but who sustain such relations to them as would make it unlikely that members of Congress would rise in their places and denounce our friends as lobbyists.
>
> I have no purpose to interfere with sleeping dogs and I shall, therefore, not send out a Macedonian cry for help unless the situation becomes desperate. However, I would like to have the preliminary work done in the way of selecting men who can come to Washington, if necessary, so that if I wire some time next week or a little later that we are driven to the necessity for canvassing the House and Senate these men would be available for this service.[64]

Apparently it was decided after this experience that the State committees were too loosely organized, and in July 1934 the member roads of the Association of Railway Executives adopted a resolution promulgating a plan to improve the railroad legislative machinery.[65] This time the 48 States were carved out into areas.[66]

[61] Exhibit No. 3448, ibid., p. 10455.
[62] Idem.
[63] Exhibit No. 3448, ibid., p. 10455 at pp. 10456–10457.
[64] Exhibit No. 3459, ibid., p. 10468.
[65] Ibid., p. 10076.
[66] Exhibit No. 3449, ibid., pp. 10458–10460:

N. Y., N. H. & H. R. R.	Maine, Vermont, New Hampshire, Massachusetts, Connecticut, Rhode Island.
New York Central	New York, Michigan.
Central R. R. Co. of N. J.	New Jersey.
Pennsylvania Railroad	Pennsylvania, Delaware, Indiana.
Baltimore & Ohio	Maryland.
New York, Chicago & St. Louis	Ohio.
Chesapeake & Ohio	West Virginia.
Norfolk & Western	Virginia.
Seaboard Air Line Railway	Florida.
Atlantic Coast Line	North Carolina, South Carolina.
Louisville & Nashville	Alabama, Kentucky.
N., C. & St. L.	Tennessee.
Central of Georgia	Georgia.
Illinois Central	Illinois, Mississippi.
Texas & Pacific	Louisiana.
Chicago & North Western	Wisconsin.
Chicago, Milwaukee, St. Paul & Pacific	South Dakota.
St. Louis-San Francisco	Missouri.
Missouri Pacific	Arkansas
C., R. I. & P.	Iowa.
Great Northern	Minnesota, North Dakota.
Northern Pacific	Montana, Washington.
Union Pacific	Oregon, Utah, Wyoming, Idaho.
Southern Pacific	Nevada, California, Arizona, Texas.
A., T. & S. F.	Kansas, Oklahoma, New Mexico.
C., B. & Q.	Colorado, Nebraska.

Each area was assigned to an appropriate railroad which was then responsible for organizing State associations to deal with legislative matters. The basis on which these associations were to work was outlined in letters written by Mr. Fletcher to the State organizations.[67]

In suggesting the organization of railroad associations in each State I had it in mind putting into effect a plan whereby we would be advised as to who are the influential men behind the several Congressmen, and the further thought that we might be able through personal contact or by the careful distribution of literature to influence in a perfectly proper way the judgment of the men upon whom the several Congressmen rely for support and advice. Indeed, I have thought that we might go so far as to get a mailing list which would show the names of the influential citizens of the United States, meaning thereby those who are influential in a political way, so that we might contact those men through our attorneys, employees, and representatives, and in order that we might provide them with such informative publications as are issued by the various railroad agencies and which discuss the railroad question in a careful and conservative manner. I should be glad, therefore, if you could send me with reference to each member of Congress and each Senator, dealing with each separately for filing purposes, a statement as to who he is, where he lives, what profess on he follows, what is his social and political background, and particularly who are his friends, advisors, and sponsors in each of the counties in his congressional district. I understand, of course, that the sentence just before this refers particularly to members of the House of Representatives. In the same way, however, I should like to know something about the background of the Senators and the persons on whom they probably rely for advice. I appreciate the fact that this is a pretty large order and may require a good deal of inquiry in different parts of the State, but I am seeking to assemble here in Washington a very complete record of each member of Congress with particular reference to the influences which control him and the persons on whom he relies for support. I have long been convinced that we can secure fair treatment from members of Congress only by reaching the people at home. It is a stupendous job to try to contact directly the entire body of citizenry, but it is not impossible, I think, for us to establish contact with influential persons who are real moulders of public opinion.[68]

This thorough organization was considered so admirable that when in October 1934 the A. R. E. merged with other associations to form the A. A. R., its legislative set-up was carried over intact.[69] The relationship thereafter of the State organizations to the A. A. R. was brought out in testimony by Mr. Fletcher at the subcommittee's hearings.

The CHAIRMAN. Has that been carried out, so that these railroads have been assigned to look after the "boys" throughout these various States?

Mr. FLETCHER. No, sir. In some of these States there are very well organized and fairly satisfactorily functioning State associations. In others there are not.

The CHAIRMAN. The plan provided for a subsidiary railroad association in each State, did it not?

Mr. FLETCHER. Well, as to the word "subsidiary", that is not quite the correct term It should be "railroad association". The word "subsidiary" implies that it is a subsidiary of the national association, and that it is not quite right. These associations are entirely independent of the Association of American Railroads.

The CHAIRMAN. They did work under the direction of the national Association, did they not?

[67] The elaborate organization contemplated by the A. R. E., was opposed in some States. In Georgia, for instance, the railroads felt that they could work better in an informal way and said:

"We feel that a permanent manager or secretary would be further undesirable because it might be thought that he was a retained lobbyist for the railroads." Exhibit No. 3453, ibid., p. 10463.

[68] Exhibit No. 3460, ibid., p. 10469.

[69] Exhibit No. 3444, ibid., p. 10450 at p. 10452.

Mr. FLETCHER. Only as to Federal or national matters.

The CHAIRMAN. So as to Federal matters they did work under the direction of the national Association?

Mr. FLETCHER. They were in constant contact with the national Association, and what was happening in Washington they were kept informed about, and if they could be helpful they were asked to do it.

The CHAIRMAN. In other words, if they could line up the boys in a particular State, they were asked to do it?

Mr. FLETCHER. They were asked to bring it to the attention of influential citizens in their States and solicit their support.

The CHAIRMAN. And try to have them contact their Representatives and Senators?

Mr. FLETCHER. I think that was the idea.[70]

This then constituted the basic organization of the railroads proper for carrying on legislative work.[71] The following sections describe how the carriers went outside their own organizations to secure support for legislation.

USE OF RAILROAD STAFFS

The organization of the railroads for legislative activities was initiated by their executives, attorneys, and publicity directors who might be considered as fulfilling a legitimate part of their functions in so doing.[72] However, in addition to these persons the railroads called on other of their employees to help in this work.

The CHAIRMAN. The railroads used their own employees who were hired to perform regular railroad duties, for some of these purposes?

Mr. FLETCHER. Yes, sir.[73]

In February 1932 the Kentucky roads were engaged in an effort to put through two bills in the Kentucky legislature regulating bus and truck traffic.[74] The vice president and general counsel of the Louisville & Nashville Railroad in a letter to Judge Fletcher explained his use of railroad staffs.

I communicated yesterday with every railroad attorney and every station agent and all of the Louisville and Nashville surgeons,[75] requesting that they have letters or telegrams sent from a number of the most influential friends of their respective senators and representatives, as also communications from the principal county officials.[76]

[70] Ibid., p. 10077.

[71] Shortly after the A. A. R. took over the legislative work, Mr. Fletcher suggested a further refinement of the methods for persuading Congress-men:

"I think it would be well for the person who is charged with primary responsibility in each State to assign a particular Congressman to some member of the organization or of the committee, with the request that the person to whom a particular Congressman is assigned endeavor to have him interviewed at home by as many of his influential constituents as can be persuaded to undertake the task. It would be very helpful indeed if a hundred influential citizens in each district could mention the matter to the Congressman and give him to understand that the measures advocated by the railroads meet with the approval of his constituents and that those measures which the railroads disfavor are not looked upon with approval by the influential men among the Congressman's constituents." (Exhibit No. 3462 ibid., p. 10470 at p. 10471.)

[72] Exhibit No. 3448, ibid., pp. 10455–10458.

[73] Ibid., p. 10078. See also Exhibits Nos. 3463, 3521, ibid., pp. 10471, 10513.

[74] Exhibit No. 3452, ibid., pp. 10462–10463.

[75] At the subcommittee's hearings, Mr. Fletcher explained the employment of outside doctors and lawyers on part time:

"* * * The railroads generally have in each State a firm of lawyers, or sometimes a single lawyer, who is responsible for the law business of the railroad in that State. They are sometimes called State attorneys and sometimes district attorneys. Ordinarily those men are salaried men, although they do not in every case give all of their time to the railroad's work. * * * The local attorneys and local surgeons are found in each county, or, generally speaking, there is one in each county representing the railroad that may serve that county. They are generally on what is known as a fee basis. They are paid only such amounts as they may earn by their actual service in court in the case of lawyers, or in the case of surgeons such service as they may render on the call of the railroad * * *." (Ibid., pp. 10084–10085).

[76] Exhibit No. 3452, ibid., p. 10462.

By 1934 this technique had been further refined. The Georgia and Florida railroads, for instance, wrote to Judge Fletcher that they had organized their states on the basis of congressional districts with a chairman in charge of each district and that local officials of the railroads would be directly responsible to them.

> There has been put at the disposal of these District Chairmen railroad officials, attorneys and surgeons located in the respective districts, and, such District Chairman will have the right to call upon them for any assistance he may need without the necessity of going through individual railroads.[77]

Mr. Fletcher testified that such "assistance" included political aid.[78] At the same time the North Carolina Railroad Association set up a similar system.

> It was decided that the different railroads would send to the Chairman as quickly as possible a list of its traffic representatives, particularly its traveling freight and passenger man, its local counsel, its local surgeons and agents, with their title and address, upon whom the District Chairman will be authorized to call for aid in any matters. It was also agreed that instructions should be given by each line to these parties to respond to the call of the District Chairman as and when requested.[79]

The southern railroads were not the only ones to make use of their official staffs. The Wabash Railway Co. in 1935 called on its local executives to aid in the fight to turn the work of the Federal Coordinator over to the Association of American Railroads.[80] Mr. T. M. Hayes, assistant general manager of the railroad, wrote to the Ohio Railroad Association as follows:

> * * * I addressed a letter to each one on my mailing list which includes some 750 prominent and influential citizens in the six States through which we operate, as well as addressing all Supervisory Officers on the Wabash System, asking them to handle the matter through their various departments in an endeavor to get more members of the public to express to their Senators and Congressmen the view that the office of the Federal Coordinator should be discontinued and the Association of American Railroads be permitted to handle railroad affairs.[81]

The Wabash also took the lead in January 1936 in mobilizing support for the Pettengill bill amending the long-and-short-haul provision of the Interstate Commerce Act. The help expected from local representatives of railroads was described in a letter from the superintendent of the Wabash addressed to "all agents."

> The Pettengill bill known as H. R. 3263 will be before the house of representatives in a very short time.
>
> For your private information it appears that a majority of the Congressmen are favorably for the passage of this bill. The favorable passage of this bill will give relief to the Railroads from the 4th Section of the Act to regulate commerce. In other words—if this bill is favorably passed it will give the railroads an opportunity to make lower rates to Pacific Coast points and not disrupt [i. e., lower,] intermediate rates, which will place the railroads in position to meet the competition of water carriers. * * *
>
> A representative from this office will call at your station in the next two or three days, endeavoring to secure favorable letters addressed to Congressmen in regard to the passage of this bill. If, however, circumstances are such that the representative does not show up at your station in a reasonable length of time, you are requested to contact representative citizens endeavoring to secure such letters. If you cannot secure a copy of each letter, be sure and secure the name of the citizen sending the letter, as we must have this information for our record.[82]

77 Exhibit No. 3450, ibid., p. 10460.
78 Ibid., p. 10079.
79 Exhibit No. 3451, ibid., p. 10461.
80 See pp. 38–40, supra.
81 Exhibit No. 3451, Hearings, Part XXIII, p. 10464.

This plan appeared so admirable to the Association of American Railroads that a few days later Judge Fletcher wrote to the chairmen of all the state legislative committees and suggested that they follow a similar procedure.

> Merchants and other businessmen in towns along the lines of the Wabash Railway in the State of Missouri have been canvassed in behalf of the passage of the Pettengill bill by representatives from the office of the Division Superintendent, with what seems to be especially good results. Under the plan worked out, two representatives of the superintendent's office, working with the local agent in each town, called on businessmen and other influential citizens, presented the facts as to the long-and-short-haul clause and the benefits to be expected from the passage of the Pettengill bill, H. R. 3263, and requested those upon whom they called to write their Senators and Representatives in Congress urging passage of the bill.
>
> The plan was put into motion by Mr. T. M. Hayes, Assistant General Manager. In its operation, the Division Superintendent called in all subordinate division officers for a meeting in his office at which the subject, was carefully discussed. The division was divided into territories, and two men were assigned to each territory. I attach a copy of the letter sent out by Superintendent W. W. Greenland to all agents explaining the plan.
>
> A report from one such team shows that they visited nineteen small stations and secured more than ninety expressions from local businessmen. As Mr. Hayes reports, "This is actually contacting the people at the cross-roads."
>
> I felt that you would be interested in such an example of carrying our story directly to people who should be and can be interested.[83]

The propriety of such actions was discussed at the subcommittee's hearings by Judge Fletcher.

> The CHAIRMAN. Of course, that is an attempt to stimulate people to write letters to their Congressmen and Senators and to urge outsiders to also write, and the outsiders would not know anything about the facts.
>
> Mr. FLETCHER. No, Senator Wheeler, I do not agree with you. * * *
>
> The CHAIRMAN. Well, the average fellow at a crossroads does not have the opportunity to know all the facts; he only hears one side, and therefore does not know whether the proposed legislation would be beneficial or not. Nevertheless you go ahead and get him to write a letter, and perhaps it may have some influence on some Congressman or some Senator, I don't know.
>
> Mr. FLETCHER. The theory is, and I think there is much to back it up, that efforts will be made on the other side of the question, and we think an explanation should be made of our side of the situation. We happen to know of people doing the same thing who are on the other side of the questions.
>
> The CHAIRMAN. Perhaps that is true. But whether it comes from your side or the other side it is not a very healthy or intelligent way to legislate. You ought to be able to present your views to Senators and Congressmen in Washington, and the question of the propriety of enacting legislation which is proposed ought to be decided on the facts as presented to congressional committees.
>
> Mr. FLETCHER. I think so.
>
> The CHAIRMAN. Instead of influence attempted to be brought to bear, by either side, by way of propaganda which represents one side or the other, and, generally speaking, not very intelligent propaganda at that.[84]

Western roads were particularly active in securing support for the Pettengill bill and set up a special staff to campaign for it.

> Mr. FLETCHER. * * * I think there was a special committee of railroad employees organized in the West. I would say, principally in California, though it may have extended beyond that. But four or five men were detached

82 Exhibit No. 3456, ibid., pp. 10465–10466.
83 Exhibit No. 3455, ibid., p. 10465.
84 Ibid., pp. 10083–10084.

from other duties and did work endeavoring to create sentiment with reference to the bill. I think their wages were paid by some of the railroads.

The CHAIRMAN. Their wages and their expenses were paid?

Mr. FLETCHER. I imagine so.

Mr. PELLEY. There would not be anything wrong with that, would there?

The CHAIRMAN. Excepting the fact that they claimed they represented independent views, whereas they were, as a matter of fact, being financed by the railroads.

Mr. PELLEY. Of course, the interest of those men is their jobs, primarily.

The CHAIRMAN. Some of them were interested not so much in the job as they were in the pay they were getting from the railroads.[85]

There are many problems involved in the use of railroad representatives for legislative activities: the question of the extent to which those hired to do a particular job are obligated to spend their time lobbying; the question of whether the interests of railroad agents, as well as railroad executives, are served by such legislation; and the question of whether the activities of these representatives are known to legislators or appear to be the actions of outsiders. The importance of these factors was brought out by the Chairman when he said:

> * * * You have an army of representatives, from one end of the country to the other—passenger agents, freight agents, station agents, superintendents, foremen, and other railroad people—and when that army is put on the move it constitutes a very powerful influence with reference to any piece of legislation.[86]

USE OF CHAMBERS OF COMMERCE

The advantage of using railroad staffs was that they were dependent on the railroads for their livelihood; the disadvantage was that when they were known as railroad representatives their influence was diminished by reason of the special interest they had in the situation. This disadvantage did not exist in the cases where railroads were able to get outside bodies to present the railroad point of view, although they had no direct connection with railroads.[87] Mr. Pelley, president of the Association of American Railroads, testified that this was a definite policy.

The CHAIRMAN. You, Mr. Pelley, were active in obtaining witnesses to present the railroad point of view before congressional committees in the name of chambers of commerce and other associations.

Mr. PELLEY. Yes, sir; that is quite true.[88]

[85] Ibid., pp. 10146–10147.
[86] Ibid., p. 10084.
[87] The indirect connection between railroads and outside organizations may be illustrated by a few examples of railroad contributions. (Ibid., pp. 10159–10160.)

Pennsylvania Railroad

$100,000—Benjamin Franklin Memorial.
317,940—Y. M. C. A.
42,896—Philadelphia Chamber of Commerce.
50,000—Philadelphia Business Progress Association.

Southern Pacific

$15,300—San Francisco Chamber of Commerce.
10,000—Portland Chamber of Commerce.
35,625—Los Angeles Chamber of Commerce.
50,000—California Chamber of Commerce.
30,173—Industrial Association of San Francisco.
35,625—All Year Club of Southern California.
53,750—California Taxpayers' Association.
96,000—Californians, Inc.

[88] Ibid., pp. 10138–10139.

There were many ways in which chambers of commerce could be helpful to the railroads. They were often, for instance, put forward as sponsors of legislation, though the bills were drawn up by the railroads. In 1932, the period when bus and truck competition was a serious worry to the railroads, the Motor Vehicle Committee of the A. R. E. drew up a bill to regulate busses and trucks. Mr. A. P. Russell, of the New York, New Haven & Hartford Railroad, in a letter to Mr. Fletcher marked "confidential" described the manner in which it was to be introduced in Congress.

> The sub-committee * * * prepared a bill which in our opinion would meet our requirements, if introduced, but it would not necessarily be identified as a railroad draft. This is now in the hands of Mr. Elder, who thought it might be sponsored by the New Jersey Chamber of Commerce.[89]

This bill was subsequently introduced by a New Jersey Congressman, ostensibly at the request of the Chamber of Commerce.[90] Judge Fletcher then wrote to the members of the A. R. E. legislative committee:

> Mr. Russell stated to me recently over the telephone that the bill was being championed by the Chamber of Commerce of the State of New Jersey and for that reason Mr. Russell thinks it inadvisable to let it be known, even among our own people, that this bill was prepared by railroad counsel or is in any way sponsored by any committee of the Association.
>
> I am wondering, however, if the members of our committee see any objection to circulating this bill, with the statement that it was introduced at the request of the Chamber of Commerce of New Jersey, followed by the statement that the bill seems to be fair.[91]

Thus the bill was first drawn by the railroads in such language and form that it would not bear the earmarks of a railroad measure; it was then introduced in Congress as a Chamber of Commerce bill; and finally it was circulated as a bill sponsored by an outside organization which the railroads nevertheless considered "fair."

In November 1933 Coordinator Eastman issued a questionnaire relating to Federal transportation legislation and invited chambers of commerce, boards of trade, other organizations and individuals to respond to this questionnaire.[92] It was, of course, essential that the answers be independent views in order for the Federal Coordinator to ascertain the sentiment of the country in regard to transportation problems. The railroads considered it of "vital importance to the railroads of this country that the replies of the various chambers of commerce, etc., be, as far as possible, favorable" to the point of view of the railroads.[93] Therefore Judge Fletcher prepared a set of answers which presented the views of the railroads and this was sent to the legislative committees of the A. R. E. with the following request:[94]

> Please take up with the Chamber of Commerce or any other civic organization which you think can be prevailed on to act favorably and urge them to return the questionnaire to the Federal Coordinator of Transportation with replies which will represent as far as possible our views (which are contained in Judge Fletcher's answers to the questionnaire) on this troublesome question.[95]

[89] Exhibit No. 3504, ibid., p. 10500.
[90] Exhibit No. 3505, ibid., p. 10501.
[91] Idem.
[92] Ibid., pp. 10141–10142.
[93] Exhibit No. 3510, ibid., pp. 10503–10504.
[94] Ibid., p. 10142.
[95] Exhibit No. 3510, ibid., p. 10503 at p. 10504.

As an example of the way in which this request was carried out, the North Carolina committee 2 weeks later had obtained answers from 12 chambers of commerce and commented: "The answers as a rule were very satisfactory." [96]

Apparently the activities of the railroads were so widespread that they came to the attention of the Coordinator, for in December a letter from the Virginia committee stated:

> * * * Mr. Eastman has recently criticized the railroads for endeavoring to formulate the opinions of various chambers of commerce and other organizations throughout the country * * *.[97]

At the subcommittee's hearings the Chairman concluded:

> * * * What Mr. Eastman wanted was their independent views and not the views of the railroads that were suggested to them. In other words, what he was trying to do, and what we all ought to try to do, was to get the independent views of these chambers of commerce, not based upon what the railroads think but what they themselves think. After all, you [the A. A. R.] maintain an office here and the railroads can get their views to the Coordinator or to the committees of Congress. But frequently what we would like to know is not just what the railroads think about it but what the general public thinks about it and what businessmen independently think about it. But we do not get that when the railroad attorneys in the various communities just go to them and influence them to send in what the railroads want. They naturally write the answers for them.[98]

Another way in which chambers of commerce were useful to the railroads was in appearing as witnesses for certain bills.[99] In June 1935 the Ohio Chamber of Commerce was asked to appear and testify against certain labor bills. The secretary replied:

> * * * I have discussed this matter with Mr. Karl S. Dixon, Assistant Secretary of the Ohio Chamber of Commerce, who would be available to go to Washington on what you might consider the most important of these bills. *He would, however, require coaching by you or some other experienced railroader.*[1]

At the hearings Mr. Fletcher stated that he considered "coaching" witnesses perfectly legitimate.

> The CHAIRMAN. * * * Did you coach Mr. Dixon?
>
> Mr. FLETCHER. I did not, personally; but I would say this, if you will permit me, that I should think a man who wanted to appear for the bill would welcome any kind of special information as to the type of bill and what the effect would be.
>
> The CHAIRMAN. He ought to know that before he came down to appear.
>
> Mr. FLETCHER. He ought to know enough about it to know that he was opposed to the train-limit bill and the full-crew bill.
>
> The CHAIRMAN. He ought to know the reasons why he was opposed to it, and not have to be coached on it. He ought to make up his own mind.[2]

In the case of one bill the western railroads went so far as to finance a chamber of commerce to promote this measure.[3] In September 1935 the Western Railways' Committee paid $766.88 to the Chicago Association of Commerce for "special services rendered" in promoting the bill.[4] Mr. Fletcher again testified that he could "see nothing wrong about it." [5]

> The CHAIRMAN. Wait a moment. Do you not see anything wrong about the Chicago Association of Commerce being paid by the railroads of this country to sponsor certain legislation?

[96] Exhibit No. 3511, ibid., p. 10504.
[97] Exhibit No. 3512, ibid., p. 10505.
[98] Ibid., p. 10143.
[99] Exhibit No. 3507, ibid., pp. 10502–10503.
[1] Exhibit No. 3506, ibid., p. 10502. [Italics supplied.]
[2] Ibid., p. 10148.
[3] Exhibit No. 3509, ibid., p. 10503.
[4] Exhibit No. 2308, ibid., p. 10503.
[5] Ibid., p. 10140.

> Mr. FLETCHER. Senator, I don't think it was at all different from a case where anyone has a litigation pending and has to have witnesses. That amount seems to be a modest amount; it was not more than the legitimate expenses of those who came here. The railroads were undoubtedly interested in the bill, as you know.
>
> The CHAIRMAN. They have recently appeared before the committee, and they have appeared before.
>
> Mr. FLETCHER. Many times.
>
> The CHAIRMAN. But when they appeared before the committee they never at any time stated that they were being paid by the railroads. They appeared before the committee as an association of commerce who favored it, and did not represent to the committee at any stage of the game that, as a matter of fact, they were employed by the railroads.[6]

USE OF SHIPPERS

In 1923, the American Railway Association, predecessor of the Association of American Railroads, organized thirteen regional shippers' advisory boards to provide a common meeting ground between shippers and railroads in connection with transportation requirements.[7] The boards came under the jurisdiction of the car service division of the A. A. R.[8] and their membership consisted of shippers, distributors, and receivers of freight.[9] The secretaries of the boards were on the pay roll of the A. A. R. and incidental expenses were also paid by the A. A. R.[10] Nevertheless both the shippers and the railroads maintained that the boards were independent organizations.[11]

The sole purpose of the boards during the first decade of their existence was to deal with the problem of car shortage.[12] But in 1932 the Atlantic States Shippers Advisory Board revised its constitution so that it could deal with other matters, including legislation.[13] Mr. W. H. Chandler, a member of the Board's executive committee, thereupon resigned because he felt the board was entering the field of politics under the domination of the railroads.[14] Mr. Chandler pointed out in a letter that if the Advisory Boards considered themselves "independent of the carriers," and thought that the carriers did not influence "in any way the policy of the Advisory Boards," they were only "kidding" themselves.[15]

However, it was not until 1935 that the A. A. R. made a statement approving the legislative activities of the Boards and empowering them to form legislative committees.[16] In this statement the A. A. R. said:

> The Boards afford a splendid set-up for handling all questions of this kind. Each important section of the country, and every industrial and agricultural interest in each section has both adequate and localized representation in the Board.
>
> Of the personnel of the membership in these Boards there is no need to say anything other than that it represents the leading and most intelligent thought on transportation matters of industry, agriculture, and banking in each territory and throughout the nation as a whole.[17]

[6] Idem.
[7] Ibid., p. 10147.
[8] Idem.
[9] Exhibit No. 3517, ibid., p. 10507.
[10] Ibid., p. 10147.
[11] Exhibit No. 3517, ibid., p. 10507; ibid., p. 10158.
[12] Ibid., pp. 10150–10151; Exhibit No. 3517, 3519, ibid., pp. 10507, 10509.
[13] Ibid., p. 10147.
[14] Ibid., p. 10148.
[15] Exhibit No. 3516, ibid., p. 10508.
[16] Exhibit No. 3518, ibid., p. 10508.
[17] Exhibit No. 3519, ibid., p. 10509.

Obviously, such a far-flung organization could wield great power and influence in promoting railroad legislation, and it quickly got into action. On January 29, 1935, the Northwest Shippers Advisory Board held its annual meeting and passed resolutions in favor of a special railroad bill.[18] The extent to which the American Railway Association controlled the meeting is revealed in a letter written by the head of the Car Service Division of the A. R. A. to the president of the Security Owners Association.

> You will find the discussions in the proceedings leading up to the passage of these resolutions very interesting. The antagonism shown was from a small minority block of Barge Line advocates or enthusiasts, which we use as "scenery" occasionally, and they performed very nobly in this case, although they do not know it.[19]

The purpose of this effort to make the shippers' boards appear to be independent bodies was, as the letter went on to say, in order to impress the congressmen that the railroads were not alone in the bills they were advocating but "were backed by solid public opinion."[20]

Similarly the Pacific Coast Advisory Board rallied its forces to get the Governor of California to veto the train-length-limit bill.[21] A report to the A. A. R. from the San Francisco offices stated:

> On the whole, through organized effort on the part of the railroads and my office, we have contacted practically every shipper in California.[22]

Governor Merriam subsequently vetoed the bill.[23]

At the subcommittee's hearings, Mr. Pelley, president of the A. A. R., admitted that the shippers' boards are "subsidiaries" or "arms" of the A. A. R.,[24] but maintained that the shippers were acting independently when they advocated legislation.

> The CHAIRMAN. It is clear that the A. A. R. considers the shippers' advisory boards as part and parcel of the railroad organizations and that the boards are under railroad domination?
>
> Mr. PELLEY. I do not consider them under our domination, because they can stop any time they want to, Senator.
>
> The CHAIRMAN. However, the boards have taken positions on railroad legislation claiming to be spokesmen for the shippers?
>
> Mr PELLEY. I think that is correct.[25]
>
> * * * * * * *
>
> The CHAIRMAN. * * * So that these organizations were, in fact, branches of the Association of American Railroads, although they have given out to the general public that they are speaking for the public; at least they have given that impression to Senators and Congressmen. That is what they want to convey, is it not?
>
> Mr PELLEY. They could not speak for anybody else, Senator.
>
> The CHAIRMAN. They could not?
>
> Mr. PELLEY. No, sir.
>
> The CHAIRMAN. But they are directed, as a matter of fact, to a large extent by the railroads, and you would include them as a branch of your organization?
>
> Mr. PELLEY. Yes; but when they speak they speak as individuals and as shippers. They do not speak for us. * * *[26]

[18] Exhibit No. 3524, ibid., pp. 10515–10516.
[19] Exhibit No. 3526, ibid., p. 10516 at p. 10517.
[20] Idem.
[21] Exhibit No. 3528, ibid., p. 10517.
[22] Exhibit No. 3528, ibid., p. 10518.
[23] Ibid., p. 10157.
[24] Ibid., pp. 10150–10153.
[25] Ibid., p. 10155.
[26] Ibid., p. 10158.

Mr. Pelley did not deny, however, that the A. A. R. used these subsidiary bodies in order to further the railroads' ends.

> The CHAIRMAN. The Association of American Railroads utilized the machinery of the shippers' advisory boards to promote the railroads' legislative program, did they not?
>
> Mr. PELLEY. I think the answer to that is yes—wherever it can be done.[27]

SECTIONAL LEGISLATION

The Association of American Railroads stressed as two of its objectives the creation of an organization to represent the railroads as a whole, and the formation of a national policy.[28] Its failure to achieve these aims in certain fields has already been discussed;[29] its activities in legislation furnish further examples of working at cross-purposes.

The Pettengill bill, as already noted, was intended to aid western roads to overcome water carrier competition via the Panama Canal on freight shipped by rail from the east to the west coasts.[30] But the east coast carriers did not benefit by this bill.

> The CHAIRMAN. As a matter of fact, Mr. Pelley, some of the eastern roads would not be benefited by the passage of the Pettingill bill, would they? As it matter of fact, would not some of the eastern roads find it detrimental?
>
> Mr. PELLEY. I doubt if that is true.
>
> The CHAIRMAN. How about the New York, New Haven & Hartford?
>
> Mr. PELLEY. It would not help them. In fact, I think *all New England is opposed to it.*
>
> The CHAIRMAN. As a matter of fact, it would hurt them, would it not? It would be detrimental to all the New England roads?
>
> Mr. PELLEY. I do not think it would help them a great deal.[31]

Nevertheless, the A. A. R. vigorously supported this bill. The traffic department of the Association was particularly active in urging railroads to induce influential citizens, chambers of commerce, and others to send wires to Congressmen.[32] Any expenses incurred in sending such telegrams were to be reimbursed by the A. A. R.[33] The question as to whether such activities were properly the business of the traffic department was not answered at the subcommittee's hearings, nor was any explanation offered as to why the Association sponsored a measure harmful to some of its members. The Association's support of the Pettengill bill is particularly interesting when it is remembered that in opposing revision of freight rate divisions

[27] Ibid., p. 10147. It should also be noted that in addition to shippers helping the railroads, the railroads often helped the shippers. For example in 1931 the Colgate-Palmolive-Peet Co. called on the Chicago, Milwaukee, St. Paul & Pacific Railroad to aid in opposing a bill in the Minnesota State Legislature which would be detrimental to this shipper. (Exhibit No. 3501, ibid., pp. 10498–10499.) The railroad promptly called on its representative in Minneapolis who reported back a week later:

> "* * * I told Representative Spillane that while we were not interested in the bill the fact was that one of our good customers had considerable interest in it, and for that reason, if it did not mean anything from a political standpoint, it would please me very much if he would forget it; so when I left him I had the bill in my pocket * * *."

(Exhibit No. 3503, ibid., p. 10499.)
[28] Exhibits Nos. 3427, 3435, ibid., pp. 10418, 10429; ibid., pp. 10060, 10127.
[29] See pp. 26–42, supra.
[30] See p. 52, supra.
[31] Hearings, Part XXIII, p. 10141. [Italics supplied.]
[32] Ibid., p. 10144.
[33] Exhibit No. 3513, ibid., p. 10505. At the hearings Mr. Pelley said he did not know of the A. A. R. paying for any wires unless they were included as an "overcoat" in the expense account. Ibid., p. 10146.

Mr. Pelley said that the Association was not interested in helping one road against another.[34] The Pettengill bill, of course, did exactly that. It is significant that the western roads would suffer from revised freight rate divisions while they would be helped by the Pettengill bill. It might, therefore, be surmised that the dominance of the Union Pacific in the Association had some connection with its stand.

Another problem involving sectional versus national interests is legislation aimed at the restriction of trade, such as the port-of-entry bills.[35] As spokesman for the railroads of the country the A. A. R. has repeatedly avowed its belief in the formation of a national transportation policy which would serve the best interests of the entire country.[36] Nevertheless it has continued the methods of its predecessor organizations in combating the trucking industry and in supporting legislation which has resulted in the erection of trade barriers.[37]

The advisability of such restrictions was discussed at the subcommittee's hearings with Mr. J. J. Pelley, president of the A. A. R.

Mr. BROWN. * * * The Association of American Railroads considers itself, in part at least, responsible for the whole national transportation situation, does it not? You consider that within your province, do you not?

Mr. PELLEY. The welfare of transportation is one of its objectives; yes; particularly rail transportation.

Mr. BROWN. You have a transportation division, so that you do consider truck transportation involves you, whether willingly or unwillingly; and do you consider it the wisest way to handle the problem of truck-rail competition? I mean by isolated action in States to harass trucks. Or would it be better by having a national policy?

Mr. PELLEY. I do not know of any action we have taken to harass truckers in individual States.

* * * * * * *

Senator TRUMAN. Erection of these ports of entry at State boundary lines, authorized by bills which your Association helped to lobby through the legislatures; would not that be an example?

Mr. PELLEY. I do not know that we have done any of that.

Senator TRUMAN. Well, I was only going on the record made here in the last 2 days.

Mr. PELLEY. I mean that if we sponsored such bills, I do not know much about it. * * * But I think we would favor port of entry bills if they were good. * * * We would favor action of that kind if it was fair and right.

Mr. BROWN. It sets up a tariff wall.

Mr. PELLEY. Oh, no, not a tariff wall.

Senator TRUMAN. That is what it really amounts to. It is a tariff wall against another State.

Mr. PELLEY. I understand the States that have them are very well pleased with them.

Mr. BROWN. It is not a question of whether the States were pleased with them or not. It is a question of whether the national transportation of the country is best served by a system of individual tariffs or by a national policy.

Mr. PELLEY. Well, we have not——

Senator TRUMAN (interposing). Suppose every State in the Union decided to set up a station at the boundary line and make a charge for every vehicle crossing the State line; and suppose they should decide, as some municipalities do in France, to charge a tax payable by every vehicle coming into the municipality—and one cannot enter some French towns without paying an entrance fee: do you think that would be a good thing for the commerce of the country?

Mr. PELLEY. Oh, generally speaking I would say no.

[34] Ibid., p. 9980.
[35] See pp. 16–17, supra.
[36] Hearings before the Senate Committee on Interstate Commerce, 76th Cong., 1st sess., on S. 2009; Hearings before the House Committee on Interstate and Foreign Commerce, 76th Cong., 1st sess., on H. R. 4862. Exhibit No. 3597, Hearings, Part XXIII, p. 10587; Ibid., p. 10196.
[37] Exhibits Nos. 3566, 3568, Ibid., pp. 10564–10567.

Senator TRUMAN. Of course it would not be. I do not think it could be considered a good thing. I think this matter of transportation should be handled in a national way. I think trucks under regulation ought to pay for the use of the highways, but that this is not the way to do it. The point is, that we must handle transportation in a national way if it is to be handled properly at all.[38]

In recognition of the serious effects on internal trade of lack of uniformity in State and local laws, one of the provisions of the Motor Carrier Act of 1935 reads:

The [Interstate Commerce] Commission is hereby authorized to investigate and report on the need for Federal regulation of the sizes and weight of motor vehicles and combinations of motor vehicles * * *.[39]

Three years before the passage of the Motor Carrier Act the railroads were urging uniformity in sizes and weights of motor vehicles. The Association of Railway Executives in a letter dated January 16, 1932, outlining its legislative program said:

It has been suggested * * * that it would be highly desirable if there could be uniform legislation on the subject of regulating motor vehicles, particularly with reference to maximum load, size, speed, and the like. It is hoped that the Legislative Committee will be able to frame a bill covering these features which would be recommended for adoption in all the States, so that some uniformity may be accomplished.[39a]

And 3 years after the passage of the Motor Carrier Act, in testimony before this subcommittee in 1938, counsel for the A. A. R. said:

We have to take these things as we find them. There is no national law covering the dimensions and weights of trucks, and taxes on motor vehicles using the highways. That is the situation as we find it now. If there were a national law on the subject, the question would be different, of course. * * *[40]

On the same occasion the president of the A. A. R. stated:

* * * It would be much better if we could have a national transportation law or system, as you have suggested, but we have not.[41]

However, the A. A. R. is now exercising the influence of the railroads to oppose any recommendation by the Commission that the size and weight of motor vehicles be subject to Federal regulation. In a brief filed with the I. C. C. on November 25, 1940, the A. A. R. stated:

It is the position of the railroads, * * * that Federal regulation of sizes and weight of motor vehicles in interstate commerce is neither necessary nor desirable in the public interest, and that the Commission should so find and report to Congress.[42]

In defending this position the A. A. R. is frank to admit that it fears uniformity of laws will result in increasing truck transportation and weakening the railroad industry. Its brief goes on to state that Federal regulation of sizes and weights would "increase the capacity of trucks;"[43] that the railroads "must not be weakened by the loss of needed traffic;"[44] and that:

The maintenance of the railroads of the country up to high standard of efficiency and their ability to continue adequate service to the public in peacetime, as well as in war emergency, are threatened of course when competitors extend their facilities and continuously increase the amount of traffic diverted from rail carriers.[45]

[38] Ibid., pp. 10196–10198.
[39] Section 225 of the Motor Carrier Act.
[39a] Exhibit No. 3448, Hearings, Part XXIII, p. 10453 at p. 10457.
[40] Hearings, Part XXIII, p. 10198.
[41] Idem.
[42] Before the I. C. C., Ex Parte No. MC–15. Statement on behalf of the A. A. R., p. 2.
[43] Ibid., p. 25.
[44] Ibid., p. 109.
[45] Ibid., p. 22.

Although studies made by State governments and by departments of the Federal Government have reached the conclusion that the lack of uniformity in State laws constitutes one of the most serious trade barriers in the United States,[46] the A. A. R. reached the following conclusion:

"The question of existing statutory restrictions of sizes and weights of motor vehicles being a barrier to trade between the states has no pertinency to this case for the reason that no showing is or can be made that the state statutory limits are unreasonable and discriminatory in character."[47]

ATTITUDE TOWARD CONGRESSIONAL COMMITTEES

Not only was it deemed important for the railroads to bring pressure to bear on congressmen but even more important from their standpoint was the question of having congressional committees dealing with transportation problems composed of congressmen who were favorable to the railroads.

In 1933 the Chicago, Rock Island & Pacific Railway wrote to Judge Fletcher, then chairman of the national legislative committee of the A. R. E. regarding "the matter of securing sympathetic representation in the Rivers and Harbors Committee of the House." [48] The Rock Island then suggested the names of several congressmen and asked the A. R. E.

"* * * to secure from the state legislative committees reports on these men; that is, reports as to whether they would be unfriendly to the waterways. As soon as we have the reports on these men we can then take the next step and ascertain whether they would be willing to serve on this Committee. Then we can go a step farther and try to get them on the Committee.

* * * * * * *

I do not think it is essential that these men * * * be particularly friendly to the railroads. The question is, would they be opposed to inland waterway development."[49]

The A. R. E. promptly passed these suggestions on to the state legislative committees. The letter to its Utah committee is illustrative:

"Our special representative, Mr. Dwinell, has suggested that we should endeavor to get some representation from States which are not committed to waterway programs. One of these is Utah. He is inquiring if I can ascertain whether Congressmen * * * would be suitable members of the committee from the railroad point of view. The question is whether these gentlemen would probably oppose the reckless expenditure of public funds for the extension of the waterways."[50]

The reply of the Utah representative was:

"I have had a very close personal friend, and who is also very close to Congressman * * *, interview him, and * * * [he] told my friend that if he could get on the next Rivers and Harbors Committee of the House he would consider himself very fortunate, and that we could expect him to do anything that we wished so far as the railroads were concerned."[51]

[46] Council of State Governments, Trade Barrier Research Bulletin Series, 1939. U. S. Department of Agriculture, A Special Report, "Barriers to Internal Trade in Farm Products," 1939. Works Progress Administration, Marketing Laws Survey, "Comparative Charts of State Statutes Illustrating Barriers to Trade Between States," 1939.
[47] Before the I. C. C., Ex Parte No. MC–15. Statement on behalf of the A. A. R., p. 111).
[48] Exhibit No. 3498, ibid., p. 10496.
[49] Exhibit No. 3498, ibid., p. 10497.
[50] Exhibit No. 3499, ibid., p. 10497.
[51] Exhibit No. 3500, ibid., p. 10498.

The railroads which apparently considered it fair to the rivers and harbors interests to place congressmen on that committee who "would be unfriendly to the waterways" did not look with favor on members of the Senate Committee on Interstate Commerce who were not pro-railroad.

The CHAIRMAN. You were also interested, Mr. Fletcher, in trying to get a chairman of the Interstate Commerce Committee after Senator Couzens stepped out of it?

Mr. FLETCHER. We were interested as to who should be the chairman of the committee, naturally.

The CHAIRMAN. How is that?

Mr. FLETCHER. Naturally we would be interested.

The CHAIRMAN. And you indicated that you thought Senator Couzens was about the worst chairman you could possibly have?

Mr. FLETCHER. Well, nothing except good should be said of the dead. I hope you will not ask me to comment on that.

The CHAIRMAN. * * * But without commenting upon it, you were taking an interest in who was to become chairman of the committee and who should not become chairman of the committee?

Mr. FLETCHER. It was a very important matter with us.

The CHAIRMAN. And one of the men you did not want as chairman of the committee, I believe, was myself; is not that a fact?

Mr. FLETCHER. I would think that was our attitude at that time. * * *[52]

Although the railroads were interested in the membership of congressional committees, they did not consider the hearings before such committees important. In 1934 the general counsel of the Chicago, Milwaukee, St. Paul & Pacific Railroad wrote to the president of the road as follows:

"Judge Fletcher contemplates asking the Executives to approve a plan of selecting a number of railroad men who have extensive personal acquaintance with members of this Congress to be assigned to the work of following the progress of the various bills and more particularly to the work of anticipating action thereon by discussing the bills from the standpoint of railroad interest with members of Congress with whom they are personally acquainted, such conversations to be early enough to get the railroad point of view to the individual Congressmen before they commit themselves to the proponents of the bills. Judge Fletcher's plan contemplates that persons with broad and intimate acquaintance with Congressmen that would be selected for this work would stay in Washington, during the several months of the present session or as much thereof as may be desirable. The men to be selected, as I understand it, are to be paid and their expenses are to be paid by the railroad for which they work.

"In connection with the foregoing Judge Fletcher said that members of his staff should not become involved in lobbying with individual members of Congress but should be confined to appearing before Committees at their public hearings and that expenses of lobbying work should not be paid through his office.

"In pointing out the necessity of the arrangement he is suggesting Judge Fletcher said that *hearings before the Committees are largely matters of scenery* to satisfy the public and that the effective work cannot be accomplished in the appearances of members of his staff before Committees. In his judgment the effective work in opposition to bills harmful to railroads can only be done through personal interviews with Congressmen conducted by men personally acquainted with the Congressmen they interview and for whom the interviewed Congressmen would have a feeling of respect and confidence."[53]

Mr. Fletcher defended his position at the subcommittee's hearings.

Mr. FLETCHER. * * * Very often hearings before committees do not inform the general body of Congressmen and Senators as to what occurred. Further-

[52] Ibid., p. 10133.
[53] Exhibit No. 3458, ibid., p. 10467. [Italics supplied.]

more, suppose we appear before a committee but fail to make a favorable impression, as often is the case I take it, even before the members of the committee present, certainly it seems to me there should be some way by which the general body of the Members of Congress should be informed of our point of view.

The CHAIRMAN. Could you not obtain that result by writing a letter and giving each Member of Congress your personal views with reference to any matter, either in the name of the railroad association or over the name of the president of a railroad? Instead of that what you are seeking to do is to bring some fellows down here from various States and have them hang around at the various offices to give their views in person.

Mr. FLETCHER. It was not my idea that anybody should be asked to come down here and hang around offices.

The CHAIRMAN. Your idea was to bring somebody down here who would not have to hang around, is that it?

Mr. FLETCHER. I thought he would be justified in presenting, particularly if he personally knew Members of Congress and they had confidence in him, our point of view. I fail to see anything wrong with that.[54]

This belief that personal contacts with Congressmen are the most successful means of influencing legislation, while committee hearings are largely a waste of time, was further emphasized by the railroads' attitude toward hearings before this subcommittee.

Mr. Pelley testified that while the A. A. R. had not attempted to stop the subcommittee's investigation,[55] the Association was opposed to it on the grounds that it would be futile.

Mr. PELLEY. Well, Senator Wheeler, I think I would be less than frank to you if I did not say I felt the investigation was not called for, and that probably it would not be worth the time and the money you would spend on it. I think to say anything less than that would not be frank.[56]

Seven months later, on October 15, 1938, Mr. Pelley appeared as a witness before an emergency board appointed to investigate and report on certain differences between the carriers and their employees regarding a proposed wage reduction.[57] In the course of his testimony Mr. Pelley reiterated that he considered the investigation of this subcommittee a waste of time and money.

* * * I think the general feeling was, and my feeling was, and *it has been confirmed by the investigation* for that matter, that they probably would dig into a lot of matters that had already been made known, * * *.[58]

Although Mr. Pelley was convinced that this subcommittee had not turned up anything new, it appeared in the course of the same day's hearings that the subcommittee's investigation had revealed many things which Mr. Pelley at least did not know. The purpose of the hearings was to determine whether a 15 percent wage cut which the railroads advocated was justifiable.[59] Senator Wheeler had appeared before the emergency board to testify on the many ways in which the railroads were wasting money, which, if saved, would make a wage reduction unnecessary.[60] Mr. Pelley then testified that the Senator did not have the facts to prove his contention and that the carriers were not wasting their funds.[61] Under cross-examination, however, when Mr. Pelley was asked if he were familiar with the specific examples of

[54] Ibid., p. 10088.
[55] Ibid., p. 10128.
[56] Ibid., p. 10129.
[57] Ibid., p. 10621.
[58] Ibid., p. 10628. [Italics supplied.]
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[60] Ibid., p. 10622.
[61] Ibid., pp. 10622–10626.

waste brought out in the subcommittee's hearings, he was forced to admit in practically every case that he was not. Typical answers from Mr. Pelley were, "I don't know anything about that";[62] "I don't know what they said about it";[64] "I never heard of that";[64] "I did not know that."[65]

The question then arose as to whether Mr. Pelley, president of the Association of American Railroads, an organization composed of 99 percent of the Class I railroads of the United States, had paid any attention to an investigation dealing exclusively with railroads.

Q. (By Mr. DAVIS, representative of the Brotherhood of Railroad Trainmen.) And you were present a great deal of the time at the hearing, were you not?
A. What hearing?
Q. The Wheeler Committee hearing.
A. No, sir.
Q. Are you familiar with the testimony brought out at that hearing? Have you read it?
A. No.[66]

* * * * * * *

Q. (By Mr. LOWENTHAL.) Has the testimony been communicated to you in any form?
A. Oh, we have received all of it, I think.
Q. You know what is in it?
A. I know something about it, but I have not read it all. *I have not even heard about it all.* I say that what I know would be probably what the average reader of the newspapers would get as to what happened up there except on the one day when I attended.
Q. You were there one day?
A. I think that is correct. I know I was there one day, and I think that was the only time.
Q. That is, you were there only one session?
A. I was there one session I think was all.
Q. You know that the sessions of the Committee Hearings exceed some one hundred in number?
A. Oh, I knew they were numerous.
Q. Has anybody told you the substance of the material presented at any of the sessions or most of the sessions?
A. Well, I have heard more or less about it.
Q. Then you would know what is in the record even though you had not read the testimony?
A. No, I would not know all that is in the record.
Q. Well, would you know in substance about what is in the record?
A. Well, I doubt if I would really.[67]

* * * * * * *

Q. (By Mr. HAY, one of the labor organizations' representatives.) Mr. Pelley, as I understood you, you didn't keep up with the details of the Senate Committee investigation?
A. Oh, about as you probably would if you lived in Washington, Mr. Hay, and read the morning papers—that is about all.

* * * * * * *

Q. Just a sort of a matter of general news?
A. Yes, I kept up with it fairly well, but not closely at all.

* * * * * * *

Q. You didn't take any special interest in it?
A. Not at all.
Q. Just a sort of a matter that you had a casual interest in?
A. That is right.[68]

[62] Ibid., p. 10631.
[63] Idem.
[64] Ibid., p. 10632.
[65] Ibid., p. 10635.
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[67] Ibid., p. 10629. [Italics supplied.]
[68] Ibid., pp. 10639–10640.

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[62] Ibid., p. 10631.
[63] Idem.
[64] Ibid., p. 10632.
[65] Ibid., p. 10635.
[66] Ibid., p. 10627.
[67] Ibid., p. 10629. [Italics supplied.]
[68] Ibid., pp. 10639–10640.

The Association of American Railroads was formed in answer to the challenge of the Federal Coordinator for the railroads to join together and seek a solution to the problems facing the industry. The Association not only accepted this suggestion but felt that it was so well qualified to regulate the railroads that the office of federal coordinator would no longer be necessary. Yet the president of this organization which had assumed such a great responsibility, knew no more than the "average reader of the newspapers" about an investigation dealing with the vital problems of railroad finance. Furthermore, the material compiled by this subcommittee and the thousands of pages of testimony brought out in its hearings have furnished the basis for bills introduced into Congress. But the president of the Association of American Railroads took only "a casual interest" in the proceedings.

SUMMARY AND CONCLUSIONS

During recent years millions of dollars of railroad funds have been disbursed through hundreds of associations, railroad and otherwise. This report describes the activities of outstanding examples of these organizations in the fields of education, legislation, and self-regulation.

Railroads in common with other industries, institutions, associations, and organizations have the right to present their point of view to the public. But the public has an equal right to know the source of facts and information presented to them, and some railroads have made a practice of disguising their educational activities.

In one instance a transportation study, financed by a large railroad system and widely distributed in public schools, made no mention of the fact that railroad funds were behind it. Instead it gave the impression that it was the work of a Government-sponsored institution and hence an impartial survey. Another foundation, organized at the suggestion of railroad executives and financed in part by railroad treasuries, distributed its publications to hundreds of thousands of persons. Material in these publications was subject to the censorship of railroad officials and was characterized by them as "prorailroad" in its viewpoint. Nevertheless, this foundation described itself as an "independent organization" interested only in the "presentation of facts" and failed to reveal in any instance that it received financial and other support from railroads.

Another organization also presented itself to the public as a "neutral agency," an "unbiased association" and an "independent organization." Here again investigation disclosed that the organization was brought into being primarily through the railroads, was heavily financed by railroads, and was working to protect railroads from the competition of other forms of transportation and Government regulation. Directors of this organization were selected according to their "railroad attitude," and at least some of the so-called educational material it put out originated in the offices of railroad executives who frankly admitted that such material if sponsored openly by the railroads would be discounted as too biased.

Legislative activities have also been considered one of the primary functions of railroad organizations. Here again there is no question of their right to work for or against certain legislation. Hearings before congressional committees have been designed for the very purpose of permitting interested parties to present their opinions to the Congressmen who are charged with the duty of determining the laws of the land. Railroads, however, have not always been satisfied with the channels provided for expressing their views on legislation and have referred to congressional hearings as "largely matters of scenery." Therefore, railroads have sometimes used a different approach. Elaborate mechanisms have been set up whereby the whole country is divided into areas which are assigned to various railroads for purposes of organization. Through these local divisions pressure has been

brought to bear on Congressmen to support legislation which the railroads consider favorable and to oppose bills which they consider inimical to their interests. Railroads have also been active in trying to influence appointments to congressional committees, in opposing congressional investigations of railroads, and in promoting legislation with a sectional rather than a national interest.

Railroads and railroad associations have spent large sums in lobbying for antitruck legislation. Seldom revealing their true role, they have worked "under cover" behind the fronts of taxpayers' groups, transportation associations, safety councils, and other organized groups. Among the measures thus secretly sponsored have been laws increasing taxes on trucks, limiting the size and weight of trucks and trailers, and tightening insurance and license requirements.

Enforcement of such legislation by railroads has been promoted by admittedly "deceptive" methods. Intricate spy systems have been set up to catch trucks and truckers in violation of the laws. One man subsidized by railroad funds disguised himself as a salesman of scales for weighing trucks. Another concealed his railroad connection by pretending that his major interest was in getting truckers arrested so that he could supply them with bail bonds. One agent secured valuable information for the railroads as a representative of an "independent" weekly. Staffs of railroads were organized into a vast "intelligence system" for relaying information regarding truck movements. Rewards were offered to officers of the law to arrest truckers. Fictitious complaints from constituents were used in bringing pressure to bear on legislators. Material furnished free to newspapers and supposedly coming from a disinterested source gave wide publicity to the railroads' point of view. Research studies presented as the work of impartial engineers or taxpayers' groups, but actually financed by the railroads, purported to show the damage done to highways by trucks and the inadequacy of taxation on trucks.

In their legislative work the railroad associations have called on the staffs of railroads, chambers of commerce, shippers' groups, and many others to testify in behalf of the railroads and to urge action on legislators. In many instances such groups have been paid by the railroads for their services and have then urged their views on Congressmen as those of disinterested bodies unconnected with the carriers.

The railroads entered the field of self-regulation in the depth of the depression when it was evident that measures of some kind were needed to save the industry from complete collapse. The Federal Coordinator of Transportation proposed, and the railroads accepted his proposal, that the carriers, by a concerted effort through a central organization of their own, solve the more pressing problems which faced them.

However, the railroads have failed to achieve stated objectives of the association which they set up for this purpose. The plan to absorb over a hundred railroad organizations into one all-powerful association finally resulted in amalgamating only 8. The coordination of railroad facilities which was expected to save the carriers millions of dollars annually was completed in only 24 cases out of more than 500 during a period of 3 years, and these projects were so small that there

was little resultant saving to the railroads. Machinery for self-regulation has proved of little avail in the vital fields of freight-rate divisions, private-car rates, and Pullman Co. contracts. Railroad executives testified before this subcommittee that not only has nothing been achieved, but that it is futile to expect any results from this railroad association because it is dominated by a few powerful roads which are only working for their own interests and not the interests of the railroads as a whole.

The railroad industry as a public utility serving a public interest has a responsibility to inform the public of its activities, to promote legislation for the general good, and to contribute to a solution of the industry's problems. But this report indicates that railroads and railroad associations have often resorted to indirection in offering information to the public; that railroads and railroad associations have not always been open, frank, and aboveboard in presenting legislation to Congress; and that railroads and railroad associations have often been more concerned with the selfish interests of a few rather than the needs of the industry as a whole.

PUBLISHED REPORTS

Subcommittee of the Committee on Interstate Commerce, United States Senate, pursuant to S. Res. 71 (74th Cong.), authorizing an investigation of interstate railroads and affiliates with respect to financing, reorganizations, mergers, and certain other matters.

Report No. 180 (75th Corg., 1st sess.):
"Midamerica Corporation: Extent and Adequacy of Interstate Commerce Commission Jurisdiction over Railroad Consolidation and Holding Company Control."

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Report No. 25 (76th Cong., 1st sess.):
Part 1—"A Problem in Railroad Reorganization: Reorganization Plans as Causes of Recurrent Insolvencies."
Part 2—"A Problem in Railroad Reorganization: Role of Life Insurance Companies: Missouri Pacific System."
Part 3—"Fallibility of Auditors' Certificates: Inadequacy of Price, Waterhouse & Co.'s Certificate to Missouri Pacific Stockholders."
Part 4—"Control of the Chicago & Eastern Illinois Railway Company."
Part 5—"Chicago & Eastern Illinois Ry. Co.—Concealment of Loan Transaction with C. & O. Ry. Co."
Part 6—"Need for Amendment of Section 77 of the Bankruptcy Act; Illustrative Matter in Subcommittee's Hearings and Reports in Support of S. 1869 (76th Congress, 1st session)."

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Report No. 25 (76th Cong., 3d sess.):
Part 7—"Missouri Pacific System: Reorganization, Expansion, and Financing 1915–1935."
Part 8—"Alleghany Corporation: Acquisition of Missouri Pacific Railroad Company—Devices Used to Secure Consent of Missouri Public Service Commission."
Part 9—"Missouri Pacific System—Intercompany Dividends and Advances—1926–1931."
Part 10—"Missouri Pacific System—Acquisition of Fort Worth Belt Railway Company."
Part 11—"Market Operations With Railroad Funds—Missouri Pacific Purchases of System Securities and Related Accounting Practices."
Part 12—"Control of the Chicago Great Western: Bremo Corporation."
Part 13—"Chicago Great Western Dividends."
Part 14—"Chicago Great Western Purchases of its own Stock."
Part 15—"Chicago Great Western R. R. Co.: Kansas City Southern Stock Transaction."
Part 16—"Chesapeake & Ohio Railway Company: $15,000,000 Preference Stock Issue of 1937."
Part 17—"Delaware & Hudson System—Purchases of Lehigh Valley and Wabash Stocks."
Part 18—"Chicago, Milwaukee & St. Paul Railway Company: 1925–1928 Receivership and Reorganization."
Part 19—"1925–1928 Receivership and Reorganization of the Chicago, Milwaukee & St. Paul Railway Company—Role of the Guaranty Trust Co. of New York."
Part 20—"Chicago, Milwaukee & St. Paul Railway Company: Fees and Expenses of 1925–28 Reorganization."
Part 21—"Chicago, Milwaukee, St. Paul & Pacific Railroad Company: Control of the Reorganized Company."
Part 22—"Chicago, Milwaukee, St. Paul & Pacific R. R. Co., Some Aspects of Its Financial History, 1925–35."
Part 23—"Wabash Railway Company: Income in 1930."

Part 24—"Pennroad Corporation: Formation and Initial Financing."
Part 25—"Alleghany System—Midamerica Corporation: Its Uses as a Holding Company."
Part 26—"Alleghany System—Sale by George A. Ball; Tax Avoidance Through Charitable Foundations."
Part 27—"Alleghany System—Acquisition of Control by Robert R. Young."

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Report No. 1182 (76th Cong., 3d sess.):
"Railroad Combination in the Eastern Region":
Part 1 (Before 1920).
Part 2 (1920–1924).
Part 3 (1924–1926).
Part 4 (1926–1929).
Part 5 (1930–1932).

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Report No. 26 (77th Cong., 1st sess.):
Part 1—"Alleghany Corporation: Plan for Reorganization and Merger with the Chesapeake Corporation."

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TITLE